

THE  
WAR TAX SERVICE

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1923

FROM THE RECORDS OF  
The Corporation Trust Company



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1923

## The Service

1. This War Tax Service when sent you is complete to the time of subscription. It is kept up to date by the insertion of new pages as often as new regulations, rulings or decisions are released.
2. Reports of new matter are sent you by first class mail with a Report Letter which lists the pages included in the report. The report letters are consecutively numbered. If the number of a new report indicates the non-receipt of the preceding report, or if pages are found missing, notice thereof should be sent us that we may forward duplicates.
3. The several divisions of this War Tax Service are indicated by guide cards. Every division is complete in itself including, as it does, the statutory provisions pertaining to its subject, a compilation of the regulations, decisions and rulings in force January 1, 1923, forms, new matters, and, where necessary, an index.
4. All paragraphs are numbered for reference purposes. The paragraph numbers appear in boldface type in the left margin. The numbers in small type below the paragraph numbers are references to other paragraphs bearing on the same subject. When new matter is inserted, the Service should be kept fully cross referenced by the entry of the new paragraph numbers opposite the respective preceding paragraphs to which back reference is shown.
5. The numbering of paragraphs and pages is consecutive throughout each division of the Service, differing series of paragraph and page numbers being utilized for the respective divisions.

THE CORPORATION TRUST COMPANY

37 Wall Street, New York

THE UNIVERSITY  
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JAN 1923

# THE WAR TAX SERVICE 1923

*Reporting*

Federal Estate Taxes

War-Profits and Excess-Profits Taxes  
(1918 and 1921 Acts)

Capital Stock Tax

Stamp Taxes

Sales (Excise) Taxes

Tax on Telegraph and Telephone Messages

Tax on Admissions and Dues

Special Taxes on Occupations

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*Printed in the U. S. A.*

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**THE CORPORATION TRUST COMPANY**

37 Wall Street, New York

Affiliated with

**The Corporation Trust Company System**

15 Exchange Place, Jersey City

Chicago, 112 W. Adams Street

Pittsburgh, Oliver Bldg.

Washington, Colorado Bldg.

Los Angeles, Title Ins. Bldg.

Wilmington, du Pont Bldg.

(Corp. Trust Co. of America)

Portland Me., 281 St. John St.

Philadelphia, Land Title Bldg.

Boston, 53 State Street

(Corporation Registration Co.)

St. Louis, Federal Reserve Bank Bldg.

Detroit, Dime Savings Bank Bldg.

Albany Agency, 158 State St.

Buffalo Agency, Ellicott Square Bldg

Cleveland, Guardian Building



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Running Table of Contents for Each Subject—Yellow Supplementary  
Page 1, at the Back of Each Division of the Book.  
Indexes—Blue Pages Throughout the Book.

### \*SPECIAL EXCESS-PROFITS TAX RULINGS.

See the white pages immediately following the blue-page 1918 Act Index (opposite page 400) in the excess-profits tax division of the book.  
*Please read the foreword to these supplementary rulings.*

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# The Corporation Trust Company

## SERVICE DEPARTMENT

37 WALL STREET, NEW YORK

### WAR TAX SERVICE

-REPORT NO. 45-

FINAL REPORT FOR THE 1923 SERVICE

JANUARY 3, 1924.

This Report is a part of the 1923 Service. We were mistaken in thinking that Report No. 44, dated December 27, 1923, would be the last. Internal Revenue Bulletin No. 39 (December 31, 1923) carried an Excess Profits Tax ruling.

Enclosed herewith are pages as listed below for insertion in your 1923 Service.

"Excess Profits Tax" division:

Supplementary Bulletin Rulings:

Sec. 326. Art. 831. - 29 to 32 (For substitution for Art. 831. - 29-30. - Ruling No. 45 is new.)

Perpetual Check Sheet (For substitution.)

\* \* \*

THE 1924 SERVICE.

This Report, being for the 1923 Service, is sent to all 1923 subscribers. Renewal subscriptions (for 1924) have not been received from all 1923 subscribers. We suggest that you be certain that your 1924 subscription has been sent to us. The 1924 books have been distributed and the first 1924 Report is being mailed to-day.

Very truly yours,

THE CORPORATION TRUST COMPANY.



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THE CORPORATION TRUST COMPANY

SERVICE DEPARTMENT

37 WALL STREET, NEW YORK

WAR TAX SERVICE

REPORT NO. 44-

DECEMBER 27, 1923.

Enclosed herewith are pages as listed below.

"Excess Profits Tax" division:

Supplementary Bulletin Rulings:

Sec. 326. Art. 833. - 9 (New.)

Perpetual Check Sheet (For substitution.)

"Form, Finder, etc." division:

1703 to 1706B (For substitution.)

\* \* \*

FINAL 1923 REPORT.

This is the final Report for the 1923 Service, probably. Distribution of the 1924 book will be begun at the beginning of the new year.

Very truly yours,

THE CORPORATION TRUST COMPANY.

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CHICAGO  
The Corporation Trust Company

# The Corporation Trust Company

## SERVICE DEPARTMENT

37 WALL STREET, NEW YORK

### WAR TAX SERVICE

-REPORT NO. 43-

DECEMBER 7, 1923.

Enclosed herewith are pages as listed below.

"Excess Profits Tax" division:

Supplementary Bulletin Rulings:

✓ Sec. 327. Art. 901. - 45-46 (For substitution  
for 45. - Ruling No. 31 is new.)

✓ Sec. 330. Art. 933. - 5-6 (New.)

✓ Sec. 331. Art. 941. - 19 to 22 (For substitution  
for 19-20. - Ruling No. 19  
is new.)

✓ Perpetual Check Sheet (For substitution.)

\* \* \*

ESTATE TAX.

Committee on Appeals and Review.

Attention is called to the matter on pages 35-36 of  
Internal Revenue Bulletin No. 35, December 3, 1923  
(released Dec. 6), relating to the organization of a  
Committee on Appeals and Review to hear and determine  
appeals taken from rulings of the Estate Tax division.

Very truly yours,

THE CORPORATION TRUST COMPANY.



The Corporation Trust Company

SERVICE DEPARTMENT

37 WALL STREET, NEW YORK

WAR TAX SERVICE

WAR TAX SERVICE

-REPORT NO. 42-

NOVEMBER 28, 1935

Enclosed herewith are pages as listed below.

"Excess Profits Tax" division:

Supplementary Bulletin Rulings:

Sec. 326. Art. 831 - 29-30 (For substitution

for 29, Ruling No. 44 being new.)

Perpetual Check Sheet (For substitution.)

Very truly yours,

THE CORPORATION TRUST COMPANY.

# The Corporation Trust Company

## SERVICE DEPARTMENT

37 WALL STREET, NEW YORK

## WAR TAX SERVICE

-REPORT NO. 41-

NOVEMBER 21, 1923.

Enclosed herewith are pages as listed below, all for substitution except as otherwise indicated.

"Estate Taxes" division:

✓ 155 (New.)

✓ Estate Tax Supplementary Pages 1-2

"Excess Profits Tax" division:

Supplementary Bulletin Rulings:

✓ Sec. 326. Art. 836. - 33-34 (For substitution for 33. - Ruling No. 19 is new.)

✓ Perpetual Check Sheet

"Capital Stock Tax" division:

✓ 649-650 (New.)

✓ Capital Stock Tax Supplementary Page 1

"Stamp Taxes" division:

✓ 709-710

✓ 787-788 (For substitution for page 787. - New matters begin at ¶ 4084.)

✓ Stamp Taxes Supplementary Pages 1-2

"Sales Taxes" division:

✓ 951-952 (New.)

✓ Sales Taxes Supplementary Page 1

"Forms, Binder, etc.," division:

✓ 1703 to 1706B (For substitution for pages 1703 to 1706A.)

Very truly yours,

THE CORPORATION TRUST COMPANY.



# The Corporation Trust Company

## SERVICE DEPARTMENT

37 WALL STREET, NEW YORK

## WAR TAX SERVICE

-REPORT NO. 41-

NOVEMBER 21, 1923.

Enclosed herewith are pages as listed below, all for substitution except as otherwise indicated.

"Estate Taxes" division:

✓ 155 (New.)

✓ Estate Tax Supplementary Pages 1-2

"Income Tax" division:

✓ Supplementary Bulletin Rulings:

✓ Sec. 326. Art. 836. - 33-34 (For substitution

✓ for 33. - Ruling No. 19 is new.)

✓ Perpetual Check Sheet

"Capital Stock Tax" division:

✓ 649-650 (New.)

✓ Capital Stock Tax Supplementary Page 1

"Stamp Taxes" division:

✓ 709-710

✓ 787-788 (For substitution for page 787. - New mat-

✓ ters begin at 4084.)

✓ Stamp Taxes Supplementary Pages 1-2

"Sales Taxes" division:

✓ 951-952 (New.)

✓ Sales Taxes Supplementary Page 1

"Income Tax, etc." division:

✓ 1703 to 1708 (For substitution for pages 1703 to

✓ 1708A.)

Very truly yours,

THE CORPORATION TRUST COMPANY.

# The Corporation Trust Company

## SERVICE DEPARTMENT

87 WALL STREET, NEW YORK

### WAR TAX SERVICE

-REPORT NO. 40-

OCTOBER 31, 1923.

Enclosed herewith are pages as listed below, all for substitution.

"Stamp Taxes" division:

787 (New matters begin at ¶ 4081.)

Stamp Taxes Supplementary Pages 1-2.

Very truly yours,

THE CORPORATION TRUST COMPANY.





# The Corporation Trust Company

## SERVICE DEPARTMENT

37 WALL STREET, NEW YORK

### WAR TAX SERVICE

-REPORT NO. 39-

OCTOBER 24, 1923.

Enclosed herewith are pages as designated below, all for substitution.

"Stamp Taxes" division:

✓ 787 (New matter at ¶ 4080.)

✓ Stamp Taxes Supplementary Pages 1-2

"Form, Finder, etc." division:

1705-1706

\* \* \*

WARDELL VS. BLUM.

Estate Tax: California Community Property. - See ¶ E536.

On Monday, October 22, 1923, in the United States Supreme Court leave was granted to the Government to withdraw its motion to revoke the Court's order denying the petition for a writ of certiorari in Wardell vs. Blum.

Very truly yours,

THE CORPORATION TRUST COMPANY.



THE CORPORATION OF THE DISTRICT OF COLUMBIA

SERVICE DEPARTMENT

1000 NEW YORK AVENUE, WASHINGTON, D. C.

WAR TAX SERVICE

- 1917-1918 -

SECTION 11

Enclosed herewith are forms for completion and return to the War Tax Service.

These forms should be filled out by the taxpayer or his agent, and returned to the War Tax Service, 1000 New York Avenue, Washington, D. C., by the date specified on the forms.

SECTION 12

Enclosed herewith are forms for completion and return to the War Tax Service.

On January 1, 1918, the War Tax Service was established in the Department of the Interior. The War Tax Service is now a part of the Department of the Interior. The War Tax Service is now a part of the Department of the Interior. The War Tax Service is now a part of the Department of the Interior.

Very truly yours,

THE CHIEF OF THE WAR TAX SERVICE

# The Corporation Trust Company

## SERVICE DEPARTMENT

37 WALL STREET, NEW YORK

### WAR TAX SERVICE

-REPORT NO. 38-

OCTOBER 17, 1923.

Enclosed herewith are pages as designated below.

"Estate Taxes" division:

- ✓ 153-154 (For substitution for page 153. New matters begin at ¶ E538.)
- ✓ Estate Tax Supplementary Pages 1-2 (For substitution.)

"Forms, Etc." division:

- ✓ 1703 to 1706A (For substitution for pages 1703 to 1706, page 1706A being new.)

\* \* \*

WARDELL VS. BLUM.

Estate Tax: California Community Property. - See ¶ E536.

On Monday, October 15, 1923, in the United States Supreme Court the time during which leave is granted to the Government to submit memorandum and motion to revoke denial of petition for writ of certiorari in Wardell vs. Blum is extended to October 22, 1923.

Very truly yours,

THE CORPORATION TRUST COMPANY.



# The Corporation of the City of London

## Service of the City

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## WAR TAX SERVICE

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# The Corporation Trust Company

## SERVICE DEPARTMENT

37 WALL STREET, NEW YORK

### WAR TAX SERVICE

-REPORT NO. 37-

OCTOBER 10, 1923.

Enclosed herewith are pages as designated below, all for substitution.

**"Estate Taxes" division:**

✓ 153 (New matter at ¶ E537.)

✓ Estate Taxes Supplementary Pages 1-2

**"Excess Profits Tax" division:**

Supplementary Bulletin Rulings:

✓ Sec. 325. Art. 813. - 15-16 (The asterisk note on page 16 is new.)

✓ Sec. 326. Art. 837. - 7-8 (Ruling No. 7 is new.)

✓ Sec. 326. Art. 845. - 7-8 (Ruling No. 11 is new.)

✓ Perpetual Check Sheet.

**"Stamp Taxes" division:**

785-786 (Reprinted to effect corrections as follows: Date of decision is Sept. 22, 1923, not 1922; Spanish War Revenue Act of 1898, not 1908, ¶ 4074.)

Very truly yours,

THE CORPORATION TRUST COMPANY.



# City Government of Lansing

## SERVICE DEPARTMENT

1000 East Grand Avenue

### WATER SERVICE

1000 East Grand Avenue

1000 East Grand Avenue

1000 East Grand Avenue

1000 East Grand Avenue

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1000 East Grand Avenue

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# The Corporation Trust Company

## SERVICE DEPARTMENT

37 WALL STREET, NEW YORK

### WAR TAX SERVICE

-REPORT NO. 36-

OCTOBER 3, 1923.

Enclosed herewith are pages as designated below,  
all for substitution except as otherwise noted.

"Excess Profits Tax" division:

Supplementary Bulletin Rulings:

Sec. 326. Art. 352. - 1. (Ruling No. 2 is  
new.)

Perpetual Check Sheet

473-474 (The note at end on page 474 is new.)

Excess-Profits Taxes Supplementary Pages 1-2

"Stamp Taxes" division:

785-787 (New.)

Stamp Taxes Supplementary Pages 1-2

"Forms, Finder, etc.," division:

1705-1706

\* \* \*

WARDELL VS. BLUM.

Estate Tax: California Community Property. - See ¶ E536.

On Monday, October 1, 1923, in the United States Supreme Court leave was granted to the Government to submit memorandum and motion to revoke denial of petition for writ of certiorari in Wardell vs. Blum, on or before October 15.

Very truly yours,

THE CORPORATION TRUST COMPANY.





# The Corporation Trust Company

## SERVICE DEPARTMENT

37 WALL STREET, NEW YORK

### WAR TAX SERVICE

-REPORT NO. 35-

SEPTEMBER 26, 1923.

Enclosed herewith are pages designated as follows,  
for substitution unless otherwise stated.

**"Excess Profits Tax" division:**

Supplementary Bulletin Rulings:

✓ Sec. 326. Art. 844. - 1 to 4 (For substitution for Art. 844. - 1-2, ruling No. 2 being new.)

✓ Perpetual Check Sheet

**"Stamp Taxes" division:**

✓ Stamp Taxes Supplementary Pages 1-2

**"Admissions and Dues" division:**

✓ Admissions and Dues Supplementary Page 1

Very truly yours,

THE CORPORATION TRUST COMPANY.

The Department of the Army

SERVICE DEPARTMENT

WASHINGTON, D. C.

# WAR TAX SERVICE

Form No. 10

Revised 10-1-42

Instructions are given designed to follow for completion of this form.

Supplement 1 (1942 Edition)  
For use with Form 10, 1-1-42  
For use with Form 10, 1-1-42  
For use with Form 10, 1-1-42  
For use with Form 10, 1-1-42

Blank form supplied pages 1-2

Instructions and Form 10, 1-1-42  
Instructions and Form 10, 1-1-42

Form 10, 1-1-42

THE DEPARTMENT OF THE ARMY



# The Corporation Trust Company

## SERVICE DEPARTMENT

37 WALL STREET, NEW YORK

### WAR TAX SERVICE

-REPORT NO. 34-

SEPTEMBER 20, 1923.

Enclosed herewith are pages as designated below.

"Admissions and Dues" division:

1371-1372 (For substitution for page 1371. New  
matters begin on page 1372.)

"Forms, Finder, etc.," division:

1703 to 1706 (For substitution.)

Very truly yours,

THE CORPORATION TRUST COMPANY.

The Corporation & General Company

SERVICE DEPARTMENT

ST. PAUL, MINN. 55101

# WAR TAX SERVICE

- RENT NO. 34

SEPTEMBER 30, 1945

Enclosed herewith are papers as indicated below.

1. 1945-1946 (for submission for 1946 1947)

2. 1946-1947 (for submission for 1947 1948)

3. 1947-1948 (for submission for 1948 1949)

Very truly yours,

THE CORPORATION & GENERAL COMPANY

# The Corporation Trust Company

## SERVICE DEPARTMENT

37 WALL STREET, NEW YORK

### WAR TAX SERVICE

-REPORT NO. 33-

SEPTEMBER 19, 1923.

Enclosed herewith are pages, for substitution, as listed below.

"Estate Taxes" division:

✓ 153 (New matter at ¶ E536.)

✓ Estate Tax Supplementary Pages 1-2

"Stamp Taxes" division:

✓ 781 to 784 (For substitution for page 781. New matters begin at top of page 782.)

Very truly yours,

THE CORPORATION TRUST COMPANY.



THE CHRYSLER FINANCIAL COMPANY

SERVICE DEPARTMENT

12 WALL STREET, NEW YORK

WAR TAX SERVICE

-REPLY BY 30

SEPTEMBER 15, 1935

Enclosed herewith are forms, etc. pertaining to  
1935 taxes.

Very truly yours,

JOE (New matter as per 102)

Enclosed Tax Department pages 1-2

Very truly yours,

781 to 784 (for instructions for page 781, see  
matter page 21 of page 781)

Very truly yours,

THE CHRYSLER FINANCIAL COMPANY

# The Corporation Trust Company

## SERVICE DEPARTMENT

37 WALL STREET, NEW YORK

### WAR TAX SERVICE

-REPORT NO. 32-

SEPTEMBER 12, 1923.

Enclosed herewith are pages as listed below.

"Estate Taxes" division:

- ✓ 151 to 153 (For substitution for page 151. New matters begin with the note at the bottom of page 151.)
- ✓ Estate Tax Supplementary Pages 1-2 (For substitution.)

"Excess Profits Tax" division:

Supplementary Bulletin Rulings:

- ✓ Sec. 326. Art. 851. - 7-8 (For substitution for Art. 851. - 7, ruling No. 7 being new.)
- ✓ Sec. 326. Art. 870. - 1 (New.)
- ✓ Perpetual Check Sheet (For substitution.)

Very truly yours,

THE CORPORATION TRUST COMPANY.

# The Corporation of the City of London

FINANCIAL STATEMENT

FOR THE YEAR 1900

## WAR SERVICE

1900-1901

1901-1902

1902-1903

1903-1904

1904-1905

1905-1906

1906-1907

1907-1908

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1910-1911

1911-1912

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1913-1914

1914-1915

1915-1916

1916-1917

1917-1918



# The Corporation Trust Company

## SERVICE DEPARTMENT

37 WALL STREET, NEW YORK

### WAR TAX SERVICE

-REPORT NO. 31-

SEPTEMBER 6, 1923.

Enclosed herewith are pages, for substitution, as designated below.

"Excess Profits Tax" division:

Supplementary Bulletin Rulings:

✓ Sec. 326. Art. 837. - 5 to 7. (For substitution for Art. 836. - 5-6, ruling No. 6 being new.)

✓ Perpetual Check Sheet

✓ "Stamp Taxes" division:

781 (Reprinted to embody in the caption and comment the matter referring to non par value stock.)

Very truly yours,

THE CORPORATION TRUST COMPANY.

The Corporation Trust Company

SERVICE DEPARTMENT

37 WALL STREET, NEW YORK

# WAR TAX SERVICE

REPORT NO. 21

SEPTEMBER 8, 1918

Enclosed herewith are pages for examination, as  
indicated below.

Transmitted for review

Supplementary Material

See 256 and 257 - 2 for summary

Notes for 258 - 259

Notes for 260 - 261

Notes for 262 - 263

Notes for 264 - 265

Not reported on summary in the caption and amount  
The total reported on the summary is

Very truly yours,

THE CORPORATION TRUST COMPANY

# The Corporation Trust Company

## SERVICE DEPARTMENT

37 WALL STREET, NEW YORK

### WAR TAX SERVICE

-REPORT NO. 30-

AUGUST 17, 1923.

Enclosed herewith are pages designated as follows,  
for substitution except as otherwise indicated:

"Stamp Taxes" division:

✓ 781 (New.)

✓ Supplementary Pages 1-2

"Forms, Finder, etc.," division:

✓ 1703 to 1706

Very truly yours,

THE CORPORATION TRUST COMPANY.



The Corporation First Company

SERVICE DEPARTMENT

ST. LOUIS, MISSOURI, U.S.A.

WAW TAX SERVICE

-SECTION 801-80

FORM 10-100

Enclosed herewith are forms numbered as follows:  
The information on page 100 is indicated.

Stamp Year, 1900

100 (100)

100 (100) 100

Stamp Year, 1900

100 to 100

Stamp Year, 1900

THE COMPANY'S FIRST COMPANY

# The Corporation Trust Company

## SERVICE DEPARTMENT

37 WALL STREET, NEW YORK

### WAR TAX SERVICE

-REPORT NO. 29-

AUGUST 9, 1923.

The pages listed below are enclosed herewith for substitution:

"Admissions and Dues" division:

✓ 1371

✓ Admissions and Dues Taxes Supplementary Page 1.

Very truly yours,

THE CORPORATION TRUST COMPANY.

The Corporation Trust Company

SERVICE DEPARTMENT

10 WALL STREET, NEW YORK

WAR TAX SERVICE

—FORM NO. 10

REVISED 4/1/42

The pages listed below are printed separately for  
convenience:

"Statement and List" Division

1941

Exemptions and War Tax Exemption Table 1

WAR TAX TABLE

THE CORPORATION TRUST COMPANY



# The Corporation Trust Company

## SERVICE DEPARTMENT

37 WALL STREET, NEW YORK

### WAR TAX SERVICE

-REPORT NO. 28-

AUGUST 6, 1923.

Enclosed herewith are pages designated as follows,  
for substitution except as otherwise indicated:

"Excess Profits Tax" division:

✓ 473-474

✓ Excess Profits Tax Supplementary Pages 1-2

"Stamp Taxes" division:

✓ 709-710

✓ 779 (New.)

✓ Stamp Taxes Supplementary Pages 1-2

"Forms, Finder, etc.," division:

✓ 1703 to 1706

Very truly yours,

THE CORPORATION TRUST COMPANY.

# The Department of the Treasury

## SERVICE DEPARTMENT

U. S. GOVERNMENT PRINTING OFFICE

## WAR TAX SERVICE

1917-18

1917-18

Published in accordance with the provisions of the War Tax Act, 1917, as amended, and the Regulations thereunder, as follows:

War Tax Service, 1917-18

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War Tax Service, 1917-18

War Tax Service, 1917-18

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War Tax Service, 1917-18

War Tax Service, 1917-18

1917-18

War Tax Service, 1917-18

War Tax Service, 1917-18

# The Corporation Trust Company

## SERVICE DEPARTMENT

87 WALL STREET, NEW YORK

### WAR TAX SERVICE

-REPORT NO. 27

JULY 25, 1923.

Enclosed herewith are pages as designated below:

"Excess Profits Tax" Division

#### Supplementary Bulletin Rulings:

✓ Sec. 326. Art. 857. - 3 to 5 (For substitution  
for Art. 857. - 3-4. - Ruling No. 7  
is now.)

✓ Sec. 326. Art. 862. - 13 (For substitution. -  
Ruling No. 4 is now.)

✓ Perpetual Check Sheet (For substitution.)

Very truly yours,

THE CORPORATION TRUST COMPANY.





# The Corporation Trust Company

## SERVICE DEPARTMENT

87 WALL STREET, NEW YORK

### WAR TAX SERVICE

-REPORT NO. 26-

JULY 19, 1923.

Enclosed herewith are pages as designated below:

"Excess Profits Tax" division:

Supplementary Bulletin Rulings:

✓ Sec. 326. Art. 831. - 27 to 29 (For substitution for Art. 831. - 27-28. - Ruling No. 43 is new.)

✓ Perpetual Check Sheet (For substitution.)

Very truly yours,

THE CORPORATION TRUST COMPANY.

The Corporation Trust Company

SERVICE DEPARTMENT

30 WALL STREET, NEW YORK

WARRANT SERVICE

—RECEIVED JUL. 20—

JULY 22, 1922.

Enclosed herewith are papers as designated below.

—THANK YOU FOR ORDER—

Enclosed herewith are papers as designated below.

840. 330. 447. 451. - 12 00 00 (1922-23)

Application for 447. 451. - 12-20.

Policy No. 447. 451.

Enclosed herewith are papers as designated below.

Very truly yours,

THE CORPORATION TRUST COMPANY.



# The Corporation Trust Company

## SERVICE DEPARTMENT

37 WALL STREET, NEW YORK

### WAR TAX SERVICE

-REPORT NO. 25-

JULY 18, 1923.

Enclosed herewith are pages designated as follows, all for substitution except as otherwise indicated.

"Excess Profits Tax" division:

- ✓ 471 to 473 (For substitution for page 471. - New matters begin at ¶ 1328.)
- ✓ Excess-Profits Tax Supplementary Pages 1-2

"Sales Taxes" division:

- ✓ 949-950 (For substitution for page 949. - New matters begin at ¶ 4772.)
- ✓ Sales Taxes Supplementary Page 1

"Forms, Finder, etc.," division:

- ✓ 1703 to 1706

Very truly yours,

THE CORPORATION TRUST COMPANY.

# The Corporation Trust Company

SERVICE DEPARTMENT

10 WALL STREET, NEW YORK

## WAR TAX SERVICE

-REPORT NO. 23-

-JUNE 15, 1918

Enclosed herewith are pages designated as follows:  
all for information shown as previously indicated.

-Excess-Profits Tax

441 to 473 (For information for year 1917 - New  
method under Act of 1918)

Excess-Profits Tax (Supplementary Tables 1-5)

-Sales Taxes (General)

484-500 (For information for year 1917 - New  
method under Act of 1918)

Sales Taxes (Supplementary Table 1)

-Income Taxes (General)

501 to 503

Very truly yours,

THE CORPORATION TRUST COMPANY

# The Corporation Trust Company

## SERVICE DEPARTMENT

37 WALL STREET, NEW YORK

### WAR TAX SERVICE

-REPORT NO. 24-

JULY 12, 1923.

Enclosed herewith are pages as listed below, for substitution.

"Estate Taxes" division:

- ✓ 149 to 151 (In place of page 149. - New matters begin at ¶ E516.)
- ✓ Estate Tax Supplementary Pages 1-2

"Stamp Taxes" division:

- ✓ 777-778 (For substitution for page 777. - New matters begin at ¶ 4050.)
- ✓ Stamp Taxes Supplementary Pages 1-2

"Forms, Finder, etc.," division:

- ✓ 1703 to 1706

Very truly yours,

THE CORPORATION TRUST COMPANY.



The Department of the Army

SERVICE DEPARTMENT

WASHINGTON, D. C.

WAR TAX SERVICE

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# The Corporation Trust Company

## SERVICE DEPARTMENT

37 WALL STREET, NEW YORK

### WAR TAX SERVICE

-REPORT NO. 23-

JUNE 21, 1923.

Enclosed herewith are pages as shown below.

"Excess Profits Tax" division:

Supplementary Bulletin Rulings:

- ✓ Sec. 312. Art. 791. - 5 (New.)
- ✓ Sec. 326. Art. 835. - 3-5 (For substitution  
for Art. 835. 3-4, ruling No. 4  
being new.)
- ✓ Perpetual Check Sheet (For substitution.)

"Forms, Finder, etc.," division:

- ✓ 1711 to 1716 (For substitution. - See note below.)

\* \* \*

THE NEW 3D NEW YORK COLLECTION DISTRICT.

(See page 1714.)

This new district was established by the President, as now shown, on March 5, 1923, effective April 1. We have withheld publication until now, as it was understood that a modifying Executive Order might issue changing the district so that it would include that part of Manhattan Island only lying north of 23d Street and west of 5th Avenue. Such change is now no longer expected.

Very truly yours,

THE CORPORATION TRUST COMPANY.

## WAR TAX SERVICE

1990-1991

# The Corporation Trust Company

## SERVICE DEPARTMENT

37 WALL STREET, NEW YORK

### WAR TAX SERVICE

-REPORT NO. 22-

JUNE 8, 1923.

Enclosed herewith are pages for substitution as listed below:

"Estate Taxes" division:

- ✓ 149 (New matter at ¶ E515.)
- ✓ Estate Taxes Supplementary Pages 1-2

"Telegraph and Telephone" division:

- ✓ Tel. and Tel. Supplementary Page 1

"Admissions and Dues" division:

- ✓ Admissions and Dues Supplementary Page 1

"General Administrative" division:

- ✓ 1615-1616 (Reprinted to show Revised Statutes  
Section 3226 as amended.)

Very truly yours,

THE CORPORATION TRUST COMPANY.



The Corporation Trust Company

SERVICE DEPARTMENT

30 WALL STREET, NEW YORK

WAR TAX SERVICE

RECEIVED BY

JUN 1, 1917

Enclosed herewith are copies of the following:

1. War Tax Service

2. War Tax Service

3. War Tax Service

4. War Tax Service

5. War Tax Service

6. War Tax Service

7. War Tax Service

8. War Tax Service

9. War Tax Service

10. War Tax Service

Very truly yours,

THE CORPORATION TRUST COMPANY

# The Corporation Trust Company

## SERVICE DEPARTMENT

87 WALL STREET, NEW YORK

### WAR TAX SERVICE

-REPORT NO. 21-

JUNE 6, 1923.

Enclosed herewith are pages as designated below,  
for substitution unless otherwise indicated.

"Capital Stock Tax" division:

- ✓ 645 to 648 (All new.)
- ✓ Capital Stock Tax Supplementary Page 1

"Sales Taxes" division:

- ✓ 949 (New matter at ¶ 4771.)
- ✓ Sales Taxes Supplementary Page 1

"Telegraph and Telephone" division:

- ✓ 1115 (New matter at ¶ 5580.)

"Admissions and Dues" division:

- ✓ 1371 (New.)

"Forms, Finder, etc.," division:

- ✓ 1703 to 1706

Very truly yours,

THE CORPORATION TRUST COMPANY.

# The Corporation Trust Company

SERVICE DEPARTMENT

25 WALL STREET, NEW YORK

## WAR TAX SERVICE

—RECEIVED NOV. 21—

NOV. 6, 1918

Enclosed herewith are papers as designated below.  
For classification unless otherwise indicated.

—CLASSIFIED UNDER WAR TAX SERVICE—

1045 TO 1046 (All new.)

1047 (New) (All new) (All new) (All new) (All new)

—CLASSIFIED UNDER WAR TAX SERVICE—

1048 (New) (All new) (All new) (All new) (All new)

1049 (New) (All new) (All new) (All new) (All new)

—CLASSIFIED UNDER WAR TAX SERVICE—

1050 (New) (All new) (All new) (All new) (All new)

—CLASSIFIED UNDER WAR TAX SERVICE—

1051 (New) (All new) (All new) (All new) (All new)

—CLASSIFIED UNDER WAR TAX SERVICE—

1052 TO 1053

Very truly yours,

THE CORPORATION TRUST COMPANY

# The Corporation Trust Company

## SERVICE DEPARTMENT

37 WALL STREET, NEW YORK

### WAR TAX SERVICE

-REPORT NO. 20-

JUNE 1, 1923.

Enclosed herewith are pages as designated below, for substitution except as otherwise indicated.

"Excess Profits Tax" division:

Supplementary Bulletin Rulings:

- ✓ Sec. 326. Art. 836. - 31-32 (New matter begins with Ruling No. 18.)
- ✓ " " " " - 33 (New.)
- ✓ Perpetual Check Sheet

"Sales Taxes" division:

- ✓ Sales Taxes Supplementary Page 1.

Very truly yours,

THE CORPORATION TRUST COMPANY.



The Corporation Trust Company

SERVICE DEPARTMENT

27 WALL STREET, NEW YORK

WAR TAX SERVICE

-RECEIVED NO. 20-

JUNE 1, 1923.

Enclosed receipts are marked as designated below  
(or indicated except as otherwise indicated).

"Income Tax" Receipts

Supplementary Receipts

Sec. 250, Art. 200 - 21-41 (New matter)

Also with Billings No. 10

Sec. 250, Art. 200 - 21-41 (New matter)

Supplementary Receipts

"Income Tax" Receipts

Supplementary Receipts

July 1923

THE CORPORATION TRUST COMPANY

# The Corporation Trust Company

## SERVICE DEPARTMENT

37 WALL STREET, NEW YORK

### WAR TAX SERVICE

-REPORT NO. 19-

MAY 17, 1923.

Enclosed herewith are pages designated as follows:

✓ "Excess Profits Tax" division:

✓ 471 (New.)

✓ Excess-Profits Tax Supplementary Pages 1-2 (For  
substitution.)

Very truly yours,

THE CORPORATION TRUST COMPANY.

The Corporation Trust Company

SERVICE DEPARTMENT

AT WALL STREET, NEW YORK

WAX TAX SERVICE

—SERVED BY THE—

MAY 17, 1931

Enclosed herewith are three specimens of labels

which have been used

by (Name)

Wax Tax Service for the purpose of labeling  
specimens

Very truly yours,

THE CORPORATION TRUST COMPANY

# The Corporation Trust Company

## SERVICE DEPARTMENT

37 WALL STREET, NEW YORK

### WAR TAX SERVICE

-REPORT NO. 18-

MAY 11, 1923.

Enclosed herewith are pages designated as follows, for substitution unless otherwise stated:

"Excess Profits Tax" division:

Supplementary Bulletin Rulings:

✓ Sec. 326. Art. 860. - 1 (New.)

✓ Perpetual Check Sheet

"Stamp Taxes" division:

✓ 775 to 777 (For substitution for page 775. - New matter begins at ¶ 4041.)

✓ Stamp Taxes Supplementary Page 1

"Occupations Taxes" division:

✓ 1511-1512 (Revised Form 732.)

"Forms, Finder, etc.," division:

✓ 1703 to 1706

\* \* \*

THE SLOCUM (SAGE ESTATE) CASE, ¶ 488.

The U. S. Supreme Court, on May 7, 1923, granted the petition for a writ of certiorari in this case.

Very truly yours,

THE CORPORATION TRUST COMPANY.





# The Corporation Trust Company

## SERVICE DEPARTMENT

37 WALL STREET, NEW YORK

### WAR TAX SERVICE

-REPORT NO. 17-

MAY 2, 1923.

Enclosed herewith are pages as listed below all for substitution.

"Excess Profits Tax" division:

Supplementary Bulletin Rulings:

- ✓ Sec. 326. Art. 859 - 1-2 (Ruling No. 2 is new.)
- ✓ Perpetual Check Sheet

"Capital Stock Tax" division:

✓ 607 to 608B (For substitution for pages 607-608.

Revised Form 708 is reproduced on these pages.)

### IMPORTANT

#### INTERNAL REVENUE BULLETINS.

Your attention is called to the "Special Notice" on the inside of the front cover of the April Internal Revenue Bulletin now on its way to you. By this you will note that hereafter (beginning Monday, May 7) the Bulletins will issue weekly (as during previous years) instead of monthly (as during the first 4 months of this year).

Very truly yours,

THE CORPORATION TRUST COMPANY.

The Corporation of Great Companies

SERVICE DEPARTMENT.

WAVE TALK SERVICE

1999, 2000, 2001, 2002, 2003, 2004, 2005, 2006, 2007, 2008, 2009, 2010, 2011, 2012, 2013, 2014, 2015, 2016, 2017, 2018, 2019, 2020, 2021, 2022, 2023, 2024, 2025, 2026, 2027, 2028, 2029, 2030, 2031, 2032, 2033, 2034, 2035, 2036, 2037, 2038, 2039, 2040, 2041, 2042, 2043, 2044, 2045, 2046, 2047, 2048, 2049, 2050, 2051, 2052, 2053, 2054, 2055, 2056, 2057, 2058, 2059, 2060, 2061, 2062, 2063, 2064, 2065, 2066, 2067, 2068, 2069, 2070, 2071, 2072, 2073, 2074, 2075, 2076, 2077, 2078, 2079, 2080, 2081, 2082, 2083, 2084, 2085, 2086, 2087, 2088, 2089, 2090, 2091, 2092, 2093, 2094, 2095, 2096, 2097, 2098, 2099, 2100, 2101, 2102, 2103, 2104, 2105, 2106, 2107, 2108, 2109, 2110, 2111, 2112, 2113, 2114, 2115, 2116, 2117, 2118, 2119, 2120, 2121, 2122, 2123, 2124, 2125, 2126, 2127, 2128, 2129, 2130, 2131, 2132, 2133, 2134, 2135, 2136, 2137, 2138, 2139, 2140, 2141, 2142, 2143, 2144, 2145, 2146, 2147, 2148, 2149, 2150, 2151, 2152, 2153, 2154, 2155, 2156, 2157, 2158, 2159, 2160, 2161, 2162, 2163, 2164, 2165, 2166, 2167, 2168, 2169, 2170, 2171, 2172, 2173, 2174, 2175, 2176, 2177, 2178, 2179, 2180, 2181, 2182, 2183, 2184, 2185, 2186, 2187, 2188, 2189, 2190, 2191, 2192, 2193, 2194, 2195, 2196, 2197, 2198, 2199, 2200, 2201, 2202, 2203, 2204, 2205, 2206, 2207, 2208, 2209, 2210, 2211, 2212, 2213, 2214, 2215, 2216, 2217, 2218, 2219, 2220, 2221, 2222, 2223, 2224, 2225, 2226, 2227, 2228, 2229, 2230, 2231, 2232, 2233, 2234, 2235, 2236, 2237, 2238, 2239, 2240, 2241, 2242, 2243, 2244, 2245, 2246, 2247, 2248, 2249, 2250, 2251, 2252, 2253, 2254, 2255, 2256, 2257, 2258, 2259, 2260, 2261, 2262, 2263, 2264, 2265, 2266, 2267, 2268, 2269, 2270, 2271, 2272, 2273, 2274, 2275, 2276, 2277, 2278, 2279, 2280, 2281, 2282, 2283, 2284, 2285, 2286, 2287, 2288, 2289, 2290, 2291, 2292, 2293, 2294, 2295, 2296, 2297, 2298, 2299, 2300, 2301, 2302, 2303, 2304, 2305, 2306, 2307, 2308, 2309, 2310, 2311, 2312, 2313, 2314, 2315, 2316, 2317, 2318, 2319, 2320, 2321, 2322, 2323, 2324, 2325, 2326, 2327, 2328, 2329, 2330, 2331, 2332, 2333, 2334, 2335, 2336, 2337, 2338, 2339, 2340, 2341, 2342, 2343, 2344, 2345, 2346, 2347, 2348, 2349, 2350, 2351, 2352, 2353, 2354, 2355, 2356, 2357, 2358, 2359, 2360, 2361, 2362, 2363, 2364, 2365, 2366, 2367, 2368, 2369, 2370, 2371, 2372, 2373, 2374, 2375, 2376, 2377, 2378, 2379, 2380, 2381, 2382, 2383, 2384, 2385, 2386, 2387, 2388, 2389, 2390, 2391, 2392, 2393, 2394, 2395, 2396, 2397, 2398, 2399, 2400, 2401, 2402, 2403, 2404, 2405, 2406, 2407, 2408, 2409, 2410, 2411, 2412, 2413, 2414, 2415, 2416, 2417, 2418, 2419, 2420, 2421, 2422, 2423, 2424, 2425, 2426, 2427, 2428, 2429, 2430, 2431, 2432, 2433, 2434, 2435, 2436, 2437, 2438, 2439, 2440, 2441, 2442, 2443, 2444, 2445, 2446, 2447, 2448, 2449, 2450, 2451, 2452, 2453, 2454, 2455, 2456, 2457, 2458, 2459, 2460, 2461, 2462, 2463, 2464, 2465, 2466, 2467, 2468, 2469, 2470, 2471, 2472, 2473, 2474, 2475, 2476, 2477, 2478, 2479, 2480, 2481, 2482, 2483, 2484, 2485, 2486, 2487, 2488, 2489, 2490, 2491, 2492, 2493, 2494, 2495, 2496, 2497, 2498, 2499, 2500, 2501, 2502, 2503, 2504, 2505, 2506, 2507, 2508, 2509, 2510, 2511, 2512, 2513, 2514, 2515, 2516, 2517, 2518, 2519, 2520, 2521, 2522, 2523, 2524, 2525, 2526, 2527, 2528, 2529, 2530, 2531, 2532, 2533, 2534, 2535, 2536, 2537, 2538, 2539, 2540, 2541, 2542, 2543, 2544, 2545, 2546, 2547, 2548, 2549, 2550, 2551, 2552, 2553, 2554, 2555, 2556, 2557, 2558, 2559, 2560, 2561, 2562, 2563, 2564, 2565, 2566, 2567, 2568, 2569, 2570, 2571, 2572, 2573, 2574, 2575, 2576, 2577, 2578, 2579, 2580, 2581, 2582, 2583, 2584, 2585, 2586, 2587, 2588, 2589, 2590, 2591, 2592, 2593, 2594, 2595, 2596, 2597, 2598, 2599, 2600, 2601, 2602, 2603, 2604, 2605, 2606, 2607, 2608, 2609, 2610, 2611, 2612, 2613, 2614, 2615, 2616, 2617, 2618, 2619, 2620, 2621, 2622, 2623, 2624, 2625, 2626, 2627, 2628, 2629, 2630, 2631, 2632, 2633, 2634, 2635, 2636, 2637, 2638, 2639, 2640, 2641, 2642, 2643, 2644, 2645, 2646, 2647, 2648, 2649, 2650, 2651, 2652, 2653, 2654, 2655, 2656, 2657, 2658, 2659, 2660, 2661, 2662, 2663, 2664, 2665, 2666, 2667, 2668, 2669, 2670, 2671, 2672, 2673, 2674, 2675, 2676, 2677, 2678, 2679, 2680, 26

## IMPORTANT

Your attention is called to the Special Meeting  
 on the issue of the future of the April  
 Avenue Building now on the way to go. By this  
 will note that meeting beginning Monday, May 11  
 Building will issue weekly and during previous  
 instead of monthly, including the first & second of  
 this year.

# The Corporation Trust Company

## SERVICE DEPARTMENT

37 WALL STREET, NEW YORK

### WAR TAX SERVICE

-REPORT NO. 16-

APRIL 25, 1923.

Enclosed herewith are pages for substitution as shown below.

"Sales Taxes" division:

✓ 947 to 949 (For substitution for page 947. - New matters begin at ¶ 4766.)

✓ Sales Taxes Supplementary Page 1

"Forms, Finder, etc.," division:

✓ 1705-1706

\* \* \*

THE CAPITAL STOCK TAX MASSACHUSETTS TRUST CASES.

These cases (see ¶ 3161) have been assigned for argument April 30, 1923.

\* \* \*

CAPITAL STOCK TAX RETURN FORM FOR FOREIGN CORPORATIONS.

Form 708 for 1924 return (during July, 1923) has been released by the Government and is being reproduced for the Service.

Very truly yours,

THE CORPORATION TRUST COMPANY.



# The Corporation Trust Company

## SERVICE DEPARTMENT

40 WALL STREET, NEW YORK

### WAR TAX SERVICE

OFFICE NO. 10

APRIL 25, 1918

Enclosed herewith are forms for information on  
shown below.

State of New York  
Set to 010 (100) and to 011 (100) for each day  
of the month of April 1918.  
These forms should be filed with the  
State Tax Commission.

100-1000  
100-1000

THE CAPITAL TRUST AND INVESTMENT TRUST COMPANY

These forms are to be filed with the  
State Tax Commission.

CAPITAL TRUST TAX RETURN FORM FOR FISCAL YEAR 1918

Form No. 100 (100) and to 011 (100) for each day  
of the month of April 1918.  
These forms should be filed with the  
State Tax Commission.

Very truly yours,

THE CORPORATION TRUST COMPANY

# The Corporation Trust Company

## SERVICE DEPARTMENT

37 WALL STREET, NEW YORK

### WAR TAX SERVICE

-REPORT NO. 15-

APRIL 17, 1923.

Enclosed are pages as listed below, all being for substitution.

✓ "Excess Profits Tax" division:

✓ Excess-Profits Tax Supplementary Page 1 (To list T. D. 3458, merely.)

✓ "Capital Stock Tax" division:

✓ 603 to 606 (Revised Form 707 for 1924 return.)

✓ 643-644 (The asterisk note on page 644 is new.)

✓ "Stamp Taxes" division:

✓ 709-710 (To show reference to amended Article 5, of Reg. 40.)

✓ 775 (New matter at ¶ 4040.)

Stamp Taxes Supplementary Pages 1-2

✓ "Sales Taxes" division:

✓ Sales Taxes Supplementary Page 1 (To list T. D. 3443, merely.)

Very truly yours,

THE CORPORATION TRUST COMPANY.

The Corporation General Company

SERVICE DEPARTMENT

10 WALL STREET NEW YORK

WAR TAC SERVICE

—COUNT NO. 12

ATTEST BY 1923

THESE ARE THE NAMES OF THE PERSONS WHOSE NAMES ARE LISTED IN THE

LIST OF THE NAMES OF THE PERSONS WHOSE NAMES ARE LISTED IN THE

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LIST OF THE NAMES OF THE PERSONS WHOSE NAMES ARE LISTED IN THE

THE CORPORATION GENERAL COMPANY

# The Corporation Trust Company

## SERVICE DEPARTMENT

37 WALL STREET, NEW YORK

### WAR TAX SERVICE

-REPORT NO. 14-

MARCH 30, 1923.

Enclosed herewith are pages as listed below.

"Excess Profits Tax" division:

#### Supplementary Bulletin Rulings:

- ✓ Sec. 304. Art. 752. - 1 (New.)
- ✓ Sec. 326. Art. 857. - 3-4 (For substitution,  
ruling number 6 being new.)
- ✓ Perpetual Check Sheet (For substitution.)

Very truly yours,

THE CORPORATION TRUST COMPANY.



The Department of the Army

SERVICE DEPARTMENT

WASHINGTON, D. C.

WAR TAX SERVICE

OFFICE NO. 11

APRIL 10, 1918

Enclosed herewith are papers for the War Tax Service.

Very respectfully,  
The Adjutant General

Adjutant General's Office

Box 101, New York, N. Y.

Box 101, New York, N. Y. - 10001

Box 101, New York, N. Y. - 10001

Box 101, New York, N. Y. - 10001

Box 101, New York, N. Y. - 10001

Very truly yours,

The Adjutant General

# The Corporation Trust Company

## SERVICE DEPARTMENT

37 WALL STREET, NEW YORK

### WAR TAX SERVICE

-REPORT NO. 13-

MARCH 16, 1923.

Enclosed herewith are pages for substitution as listed below.

"Occupations Taxes" division:

- ✓ 1513-1514 (Arts. 43 and 44 amended. List on page 1514.)
- ✓ 1535-1536 (New matter begins on page 1535, ¶ 7663.)
- ✓ Occupations Taxes Supplementary Page 1.

Very truly yours,

THE CORPORATION TRUST COMPANY.

THE UNIVERSITY OF CHICAGO

Enclosed herewith are copies for information as  
requested.

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8855 2021 0000 0000 0000 0000 0000 0000 0000 0000

# The Corporation Trust Company

## SERVICE DEPARTMENT

37 WALL STREET, NEW YORK

### WAR TAX SERVICE

-REPORT NO. 12-

MARCH 12, 1923.

Enclosed herewith are pages as designated below. There appear on these pages such new excess-profits tax rulings as are printed in the February 1923 Internal Revenue Bulletin, released by the Government, for publication, on March 10.

"Excess Profits Tax" division:

#### Supplementary Bulletin Rulings:

- ✓ Sec. 325. Art. 813. - 15-16 (For substitution for 15. Ruling No. 10 is new.)
- ✓ Sec. 326. Art. 831. - 25 to 28 (For substitution for 25-26. Ruling No. 42 is new.)
- ✓ Sec. 326. Art. 836. - 27 to 32 (For substitution for 27-28. Ruling No. 17 is new.)
- ✓ Sec. 331. Art. 941. - 19-20 (For substitution. Ruling No. 18 is new.)
- ✓ Perpetual Check Sheet (For substitution.)

Very truly yours,

THE CORPORATION TRUST COMPANY.





# The Corporation Trust Company

## SERVICE DEPARTMENT

37 WALL STREET, NEW YORK

### WAR TAX SERVICE

- REPORT NO. 11-

MARCH 5, 1923.

Enclosed herewith are pages for substitution as listed below:

"Stamp Taxes" division:

- ✓ 773 to 775 (New matter begins at 4034.)
- ✓ Stamp Taxes Supplementary Pages 1-2

\* \* \*

#### THE FEBRUARY INTERNAL REVENUE BULLETIN.

The February Internal Revenue Bulletin has not yet been issued by the Bureau. The Bulletin is printed by the Government Printing Office, and that office has been fully occupied during the past week with matters incident to the closing days of Congress.

Very truly yours,

THE CORPORATION TRUST COMPANY.

THE UNIVERSITY OF CHICAGO

RESEARCH DEPARTMENT

CHICAGO, ILLINOIS

WAR AND SERVICE

Vol. 1, No. 1

June 1, 1942

RESEARCH DEPARTMENT

CHICAGO, ILLINOIS

THE UNIVERSITY OF CHICAGO

RESEARCH DEPARTMENT

CHICAGO, ILLINOIS

RESEARCH DEPARTMENT

CHICAGO, ILLINOIS

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CHICAGO, ILLINOIS

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RESEARCH DEPARTMENT

CHICAGO, ILLINOIS

# The Corporation Trust Company

## SERVICE DEPARTMENT

37 WALL STREET, NEW YORK

### WAR TAX SERVICE

WAR REPORT REG. 10-1

FEBRUARY 13, 1923.

Enclosed herewith are pages, as listed below, all for substitution except as otherwise indicated.

"Capital Stock Tax" division:

✓ Capital Stock Tax Supplementary Page 1

"Sales Taxes" division:

✓ 945 to 947 (N.W.)

✓ Sales Taxes Supplementary Page 1

"Admissions and Dues" division:

✓ 1365 to 1370 (For substitution for page 1365, new matter beginning at ¶ 6841.)

✓ Admissions and Dues Supplementary Page 1

"Forms, Finder, etc." division:

✓ 1705-1706

Very truly yours,

THE CORPORATION TRUST COMPANY.





# The Corporation Trust Company

## SERVICE DEPARTMENT

37 WALL STREET, NEW YORK

### WAR TAX SERVICE

-REPORT NO. 9-

FEBRUARY 13, 1923.

Enclosed herewith are pages, for substitution as designated below.

"Stamp Taxes" division:

✓ 771 to 774 (For substitution for pages 771-772, new matter beginning at § 4032.)

✓ Stamp Taxes Supplementary Pages 1-2.

"Forms, Finder, etc.," division.

✓ 1703-1704

Very truly yours,

THE CORPORATION TRUST COMPANY.

UNITED STATES DEPARTMENT OF THE INTERIOR

BUREAU OF LAND MANAGEMENT

WASHINGTON, D. C. 20090

WAR TAX SERVICE

RECEIVED

FEBRUARY 11, 1945

Enclosed is a copy of the War Tax Service Manual, 1944-1945, as revised.

Very truly yours,

JOHN C. WATSON, Director

UNITED STATES DEPARTMENT OF THE INTERIOR

BUREAU OF LAND MANAGEMENT

WASHINGTON, D. C. 20090

1700-101

Very truly yours,

JOHN C. WATSON, Director

# The Corporation Trust Company

## SERVICE DEPARTMENT

37 WALL STREET, NEW YORK

### WAR TAX SERVICE

-REPORT NO. 8-

FEBRUARY 9, 1923.

Enclosed herewith are pages for substitution as listed below.

"Excess Profits Tax" division:

✓ 424a-424b (Rev. Form 1122 on page 424b.)

Very truly yours,

THE CORPORATION TRUST COMPANY.



The Department of the Interior

RECEIVED

U. S. DEPARTMENT OF THE INTERIOR

WAR TANK SERVICE

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# The Corporation Trust Company

## SERVICE DEPARTMENT

37 WALL STREET, NEW YORK

### WAR TAX SERVICE

-REPORT NO. 7-

FEBRUARY 7, 1923.

Enclosed herewith are pages designated as follows:

"Excess Profits Tax" division:

- ✓ 465 to 470 (New.)
- ✓ Excess-Profits Tax Supplementary Pages 1-2. (For substitution.)

"Forms, Finder, etc." division:

- ✓ 1705-1706 (For substitution.)

\* \* \*

FORM 1122.

Form 1122 will be released by the Government on Saturday, February 10, 1923. This is for the information return of subsidiary or affiliated corporation whose net income and invested capital are included in return of parent or principal reporting corporation for excess-profits tax purposes for fiscal years ended in 1922.

Very truly yours,

THE CORPORATION TRUST COMPANY.

The Corporation General Company

SERVICE DEPARTMENT

AT 1111 STREET NEW YORK

WAR TAX SERVICE

February 7, 1942

Enclosed herewith are copies of the following

War Tax Service Department

442 12 470 (Rev. 1)

War Tax Service Department  
Enclosed herewith are copies of the following  
War Tax Service Department

War Tax Service Department

442 12 470 (Rev. 1)

War Tax Service Department

Form 1000 will be released by the Government on  
Saturday, February 14, 1942. This is the latest  
edition of the form and contains all the latest  
changes and instructions. It is included in  
the War Tax Service Department's publication  
of forms and instructions for limited years ended in  
1942.

War Tax Service Department

THE CORPORATION GENERAL COMPANY

# The Corporation Trust Company

## SERVICE DEPARTMENT

37 WALL STREET, NEW YORK

### WAR TAX SERVICE

-REPORT NO. 6-

FEBRUARY 2, 1923.

Enclosed herewith are pages, for substitution, as indicated below.

"Excess Profits Tax" division:

Supplementary Bulletin Rulings:

✓ Sec. 326. Art. 845. - 7-8 (Ruling No. 10 is new.)

✓ Perpetual Check Sheet

Very truly yours,

THE CORPORATION TRUST COMPANY.



The Corporation of the City of London

THE CORPORATION OF THE CITY OF LONDON

By Order of the Common Council

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# The Corporation Trust Company

## SERVICE DEPARTMENT

37 WALL STREET, NEW YORK

### WAR TAX SERVICE

-REPORT NO. 5-

JANUARY 30, 1923.

Enclosed herewith are pages designated as follows:

"Estate Taxes" division:

- ✓ Estate Tax Fore-page (For substitution for the sheet now in the binder immediately following the yellow "Estate Taxes" guide card.)
- ✓ 13 to 28E (For substitution for pages 13 to 28. - Revised Form 706.)

"Excess Profits Tax" division:

- ✓ 424a-424b (New, to follow page 424. - Revised Form 1120 S.)

"Forms, Finder, etc.," division:

- ✓ 1703-1704 (For substitution.)

Very truly yours,

THE CORPORATION TRUST COMPANY.



# The Corporation Trust Company

## SERVICE DEPARTMENT

37 WALL STREET, NEW YORK

### WAR TAX SERVICE

-REPORT NO. 4-

JANUARY 26, 1923.

Enclosed herewith are pages as designated below -  
for substitution unless otherwise noted.

"Admissions and Dues" division:

✓ 1365 (New.)

✓ Admissions and Dues Supplementary Page 1.

"Forms, Finder, etc.," division:

✓ 1705-1706

\* \* \*

FORM 1120 S.

Form 1120 S - Government contracts profits tax return for fiscal year ending in 1922, is announced for release on January 31, 1923.

Very truly yours,

THE CORPORATION TRUST COMPANY.



The Corporation Trust Company

SERVICE DEPARTMENT

100 WALL STREET, NEW YORK

WAR TAX SERVICE

FORM NO. 1-A

JANUARY 20, 1933

Enclosed herewith are copies as designated below  
for submission unless otherwise noted.

Enclosures and Form No. 1

1933 (Rev. 1)

Administrative and Other Supplementary Page 1

Form No. 1-A, 1933

1933-1934

FORM NO. 1-A

Form No. 1-A, 1933. Government contracts for the  
year 1933. Form No. 1-A, 1933. Form No. 1-A, 1933.  
release in January 21, 1933.

NOT A COPY

THE CORPORATION TRUST COMPANY

# The Corporation Trust Company

## SERVICE DEPARTMENT

37 WALL STREET, NEW YORK

### WAR TAX SERVICE

-REPORT NO. 3-

JANUARY 23, 1923.

Enclosed herewith are pages designated as follows:

"Excess Profits Tax" division:

✓ 424-c to 424-h (Insert these pages to follow page 424. There are no pages 424a-b, at present. On these new pages 424-c to 424-h, sent herewith, is reproduced old Form 1120A, inadvertently omitted when the Service was distributed.)

✓ Excess-Profits Tax Supplementary Pages 1-2 (For substitution. The reference to T. D. 3429, on page 2, is new.)

"General Administrative" division:

✓ 1625 (For substitution. - The note in brackets following ¶ 8106 is the new matter.)

Very truly yours,

THE CORPORATION TRUST COMPANY.

# The Corporation of the City of London

## SERVICE OF THE CITY

By the City of London

## WAR TAX SERVICE

Section 10, 1915

Section 11, 1915

Section 12, 1915

Section 13, 1915

Section 14, 1915

Section 15, 1915

Section 16, 1915

Section 17, 1915

Section 18, 1915

Section 19, 1915

Section 20, 1915

Section 21, 1915

Section 22, 1915

Section 23, 1915

Section 24, 1915

Section 25, 1915

Section 26, 1915

Section 27, 1915

# The Corporation Trust Company

## SERVICE DEPARTMENT

37 WALL STREET, NEW YORK

WAR TAX SERVICE

-REPORT NO. 2-

JANUARY 11, 1923.

## WAR TAX SERVICE

-REPORT NO. 2-

JANUARY 11, 1923.

Enclosed herewith are pages as designated below, for substitution unless otherwise stated:

"Estate Taxes" division:

- ✓ 145 to 149 (New.)
- ✓ Estate Tax Supplementary Pages 1-2

"Capital Stock Tax" division:

- ✓ 841 to 844 (New.)
- ✓ Capital Stock Tax Supplementary Page 1

"Stamp Taxes" division:

- ✓ Stamp Taxes Supplementary Pages 1-2

"Forms, Binder, etc.," division:

- ✓ 1703-1706

Very truly yours,

THE CORPORATION TRUST COMPANY.



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AT WASHINGTON, D.C.

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# The Corporation Trust Company

## SERVICE DEPARTMENT

37 WALL STREET, NEW YORK

## WAR TAX SERVICE

-REPORT NO. 1-

JANUARY 5, 1923.

First report for your 1923 Service book.

This Report is large, of necessity, as it contains, in addition to new matters, late 1922 matters previously issued in the 1922 Service, and now reprinted to bring the 1923 Service up to date.

Enclosed herewith are pages for insertion in your new 1923 Service book, for substitution except as otherwise noted:

### "Excess Profits Tax" division:

#### Supplementary Bulletin Rulings:

- ✓ Sec. 325. Art. 817. -1 (New.)
- ✓ Sec. 325. Art. 831. - 25-26.
- ✓ Sec. 326. Art. 833. - 7-8.
- ✓ Sec. 326. Art. 836. - 25 to 28 (New.)
- ✓ Sec. 326. Art. 840. - 11.
- ✓ Sec. 326. Art. 845. - 7 (New.)
- ✓ Perpetual Check Sheet.
- ✓ 463-464 (New. - 1923 Supreme Court decision.)
- ✓ Excess-Profits Tax Supplementary Pages 1-2.

### "Stamp Taxes" division:

- ✓ 771-772 (New. - See Court decision at ¶ 4028.)
- ✓ Stamp Taxes Supplementary Pages 1-2

### "General Administrative" division:

- ✓ 1605-1606 (The old pages were reversed, in printing.)
- ✓ 1623 to 1625 (1624-1625 carry a 1923 Supreme Court decision.)

### "Forms, Finder, etc." division:

✓ 1705-1706

Very truly yours,  
THE CORPORATION TRUST COMPANY.

UNIVERSITY OF MICHIGAN LIBRARY

SERVICE DEPARTMENT

THE UNIVERSITY OF CHICAGO

## WAR TAX SERVICE

-5- (SA THOMAS)

the 1953 Survey of the State  
 showed in the 1953 Survey  
 in addition to the 1953 Survey  
 This Survey is being prepared  
 as of 1953.

new 1967 Service Book, for consideration through the  
 National Council, and please for insertion in your  
 next issue.

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(1991) 22 of 22

141	040	FTA	852	793
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1. 1997, 2000, 2003, 2006, 2009, 2012, 2015, 2018, 2021, 2024, 2027, 2030, 2033, 2036, 2039, 2042, 2045, 2048, 2051, 2054, 2057, 2060, 2063, 2066, 2069, 2072, 2075, 2078, 2081, 2084, 2087, 2090, 2093, 2096, 2099, 2102, 2105, 2108, 2111, 2114, 2117, 2120, 2123, 2126, 2129, 2132, 2135, 2138, 2141, 2144, 2147, 2150, 2153, 2156, 2159, 2162, 2165, 2168, 2171, 2174, 2177, 2180, 2183, 2186, 2189, 2192, 2195, 2198, 2201, 2204, 2207, 2210, 2213, 2216, 2219, 2222, 2225, 2228, 2231, 2234, 2237, 2240, 2243, 2246, 2249, 2252, 2255, 2258, 2261, 2264, 2267, 2270, 2273, 2276, 2279, 2282, 2285, 2288, 2291, 2294, 2297, 2300, 2303, 2306, 2309, 2312, 2315, 2318, 2321, 2324, 2327, 2330, 2333, 2336, 2339, 2342, 2345, 2348, 2351, 2354, 2357, 2360, 2363, 2366, 2369, 2372, 2375, 2378, 2381, 2384, 2387, 2390, 2393, 2396, 2399, 2402, 2405, 2408, 2411, 2414, 2417, 2420, 2423, 2426, 2429, 2432, 2435, 2438, 2441, 2444, 2447, 2450, 2453, 2456, 2459, 2462, 2465, 2468, 2471, 2474, 2477, 2480, 2483, 2486, 2489, 2492, 2495, 2498, 2501, 2504, 2507, 2510, 2513, 2516, 2519, 2522, 2525, 2528, 2531, 2534, 2537, 2540, 2543, 2546, 2549, 2552, 2555, 2558, 2561, 2564, 2567, 2570, 2573, 2576, 2579, 2582, 2585, 2588, 2591, 2594, 2597, 2600, 2603, 2606, 2609, 2612, 2615, 2618, 2621, 2624, 2627, 2630, 2633, 2636, 2639, 2642, 2645, 2648, 2651, 2654, 2657, 2660, 2663, 2666, 2669, 2672, 2675, 2678, 2681, 2684, 2687, 2690, 2693, 2696, 2699, 2702, 2705, 2708, 2711, 2714, 2717, 2720, 2723, 2726, 2729, 2732, 2735, 2738, 2741, 2744, 2747, 2750, 2753, 2756, 2759, 2762, 2765, 2768, 2771, 2774, 2777, 2780, 2783, 2786, 2789, 2792, 2795, 2798, 2801, 2804, 2807, 2810, 2813, 2816, 2819, 2822, 2825, 2828, 2831, 2834, 2837, 2840, 2843, 2846, 2849, 2852, 2855, 2858, 2861, 2864, 2867, 2870, 2873, 2876, 2879, 2882, 2885, 2888, 2891, 2894, 2897, 2900, 2903, 2906, 2909, 2912, 2915, 2918, 2921, 2924, 2927, 2930, 2933, 2936, 2939, 2942, 2945, 2948, 2951, 2954, 2957, 2960, 2963, 2966, 2969, 2972, 2975, 2978, 2981, 2984, 2987, 2990, 2993, 2996, 2999, 3002, 3005, 3008, 3011, 3014, 3017, 3020, 3023, 3026, 3029, 3032, 3035, 3038, 3041, 3044, 3047, 3050, 3053, 3056, 3059, 3062, 3065, 3068, 3071, 3074, 3077, 3080, 3083, 3086, 3089, 3092, 3095, 3098, 3101, 3104, 3107, 3110, 3113, 3116, 3119, 3122, 3125, 3128, 3131, 3134, 3137, 3140, 3143, 3146, 3149, 3152, 3155, 3158, 3161, 3164, 3167, 3170, 3173, 3176, 3179, 3182, 3185, 3188, 3191, 3194, 3197, 3200, 3203, 3206, 3209, 3212, 3215, 3218, 3221, 3224, 3227, 3230, 3233, 3236, 3239, 3242, 3245, 3248, 3251, 3254, 3257, 3260, 3263, 3266, 3269, 3272, 3275, 3278, 3281, 3284, 3287, 3290, 3293, 3296, 3299, 3302, 3305, 3308, 3311, 3314, 3317, 3320, 3323, 3326, 3329, 3332, 3335, 3338, 3341, 3344, 3347, 3350, 3353, 3356, 3359, 3362, 3365, 3368, 3371, 3374, 3377, 3380, 3383, 3386, 3389, 3392, 3395, 3398, 3401, 3404, 3407, 3410, 3413, 3416, 3419, 3422, 3425, 3428, 3431, 3434, 3437, 3440, 3443, 3446, 3449, 3452, 3455, 3458, 3461, 3464, 3467, 3470, 3473, 3476, 3479, 3482, 3485, 3488, 3491, 3494, 3497, 3500, 3503, 3506, 3509, 3512, 3515, 3518, 3521, 3524, 3527, 3530, 3533, 3536, 3539, 3542, 3545, 3548, 3551, 3554, 3557, 3560, 3563, 3566, 3569, 3572, 3575, 3578, 3581, 3584, 3587, 3590, 3593, 3596, 3599, 3602, 3605, 3608, 3611, 3614, 3617, 3620, 3623, 3626, 3629, 3632, 3635, 3638, 3641, 3644, 3647, 3650, 3653, 3656, 3659, 3662, 3665, 3668, 3671, 3674, 3677, 3680, 3683, 3686, 3689, 3692, 3695, 3698, 3701, 3704, 3707, 3710, 3713, 3716, 3719, 3722, 3725, 3728, 3731, 3734, 3737, 3740, 3743, 3746, 3749, 3752, 3755, 3758, 3761, 3764, 3767, 3770, 3773, 3776, 3779, 3782, 3785, 3788, 3791, 3794, 3797, 3800, 3803, 3806, 3809, 3812, 3815, 3818, 3821, 3824, 3827, 3830, 3833, 3836, 3839, 3842, 3845, 3848, 3851, 3854, 3857, 3860, 3863, 3866, 3869, 3872, 3875, 3878, 3881, 3884, 3887, 3890, 3893, 3896, 3899, 3902, 3905, 3908, 3911, 3914, 3917, 3920, 3923, 3926, 3929, 3932, 3935, 3938, 3941, 3944, 3947, 3950, 3953, 3956, 3959, 3962, 3965, 3968, 3971, 3974, 3977, 3980, 3983, 3986, 3989, 3992, 3995, 3998, 4001, 4004, 4007, 4010, 4013, 4016, 4019, 4022, 4025, 4028, 4031, 4034, 4037, 4040,

1990-1991: The first year was devoted to general

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1. 四角土庫上之木釘

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## ESTATE TAX.

**1921 Law Provisions.**—In effect after 3.55 P. M., Nov. 23, 1921.....Page 3

**Regulations No. 63**.....Page 35

In which are embodied forward references to

**Supplementary Rulings, Decisions, etc., prior to January 1, 1923**.... ¶256

All of which are fully indexed at the back of this division.

**Forms:**

704	Executor's 2-month notice (resident estates).....	Page 29
705	Executor's 2-month notice (nonresident estates).....	Page 31*
706	Return of gross estate.....	Page 13
714	Transfer agent's notice: Estate of nonresident.....	Page 33
760	Affidavit of ownership of bonds or notes.....	¶382
791	Application for release of estate tax lien.—Not reproduced. See ¶231.	
792	Certificate releasing estate tax lien.—Not reproduced. See ¶230.	
793	Claim for exemption on account of military service.—Not reproduced. See ¶68.	

\*To be used until revised form is issued.

**Amendments, Rulings, Decisions, etc., since January 1, 1923**.....¶488

[See yellow Supplementary Page 2 facing the index.]

(For Supreme Court Decisions prior to January 1, 1923, see ¶397.)

## ESTATE TAX.

1921 Law Provisions.—In effect after 3.55 P. M., Nov. 23, 1921. . . . Page 3

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[See yellow Supplementary Page 2 facing the index.]

(For Supreme Court Decisions prior to January 1, 1923, see ¶397.)

# ESTATE TAX LAW.

BEING TITLE IV OF THE REVENUE ACT OF 1921.

In effect after 3:55 P. M. November 23, 1921.

## CALENDAR.

### 2-month notice

Resident decedent..... ¶187 et seq.

Non-resident decedent..... ¶191 et seq.

### Return (within one year after death)

Resident decedent..... ¶196

Non-resident decedent..... ¶205

### Tax (due and payable one year from death)..... ¶213

Non-resident..... ¶186; ¶213

## Title IV.—Estate Tax.

### 1 **Sec. 400.** That when used in this title—

2 The term “executor” means the executor or administrator of the decedent, or, if there is no executor or administrator, any person in actual or constructive possession of any property of the decedent;

3 The term “net estate” means the net estate as determined under the provisions of section 403;

4 The term “month” means calendar month; and

5 The term “collector” means the collector of internal revenue of the district in which was the domicile of the decedent at the time of his death, or, if there was no such domicile in the United States, then the collector of the district in which is situated the part of the gross estate of the decedent in the United States, or, if such part of the gross estate is situated in more than one district, then the collector of internal revenue of such district as may be designated by the Commissioner.

## [Rates.]

6 **Sec. 401.** That, in lieu of the tax imposed by Title IV of the Revenue Act of 1918, a tax equal to the sum of the following percentages of the value of the net estate (determined as provided in section 403) is hereby imposed upon the transfer of the net estate of every decedent dying after the passage of this Act, whether a resident or nonresident of the United States:

7 1 per centum of the amount of the net estate not in excess of \$50,000;

2 per centum of the amount by which the net estate exceeds \$50,000 and does not exceed \$150,000;

3 per centum of the amount by which the net estate exceeds \$150,000 and does not exceed \$250,000;

4 per centum of the amount by which the net estate exceeds \$250,000 and does not exceed \$450,000;

6 per centum of the amount by which the net estate exceeds \$450,000 and does not exceed \$750,000;



8 per centum of the amount by which the net estate exceeds \$750,000 and does not exceed \$1,000,000;

10 per centum of the amount by which the net estate exceeds \$1,000,000 and does not exceed \$1,500,000;

12 per centum of the amount by which the net estate exceeds \$1,500,000 and does not exceed \$2,000,000;

14 per centum of the amount by which the net estate exceeds \$2,000,000 and does not exceed \$3,000,000;

16 per centum of the amount by which the net estate exceeds \$3,000,000 and does not exceed \$4,000,000;

18 per centum of the amount by which the net estate exceeds \$4,000,000 and does not exceed \$5,000,000;

20 per centum of the amount by which the net estate exceeds \$5,000,000 and does not exceed \$8,000,000;

22 per centum of the amount by which the net estate exceeds \$8,000,000 and does not exceed \$10,000,000; and

25 per centum of the amount by which the net estate exceeds \$10,000,000.

**8** The taxes imposed by this title or by Title II of the Revenue Act of 1916 (as amended by the Act entitled "An Act to provide increased revenue to defray the expenses of the increased appropriations for the army and navy and the extensions of fortifications, and for other purposes," approved March 3, 1917) or by Title IX of the Revenue Act of 1917, or by Title IV of the Revenue Act of 1918, shall not apply to the transfer of the net estate of any decedent who has died or may die from injuries received or disease contracted in line of duty while serving in the military or naval forces of the United States in the war against the German Government, or to the transfer of the net estate of any citizen of the United States who has died or may die from injuries received or disease contracted in line of duty while serving in the military or naval forces of any country while associated with the United States in the prosecution of such war, or prior to the entrance therein of the United States, and any tax collected upon such transfer shall be refunded to the estate of such decedent.

#### [Determination of value of gross estate.]

**9** **Sec. 402.** That the value of the gross estate of the decedent shall be determined by including the value at the time of his death of all property, real or personal, tangible or intangible, wherever situated—

**10** (a) To the extent of the interest therein of the decedent at the time of his death which after his death is subject to the payment of the charges against his estate and the expenses of its administration and is subject to distribution as part of his estate;

**11** (b) To the extent of any interest therein of the surviving spouse, existing at the time of the decedent's death as dower, curtesy, or by virtue of a statute creating an estate in lieu of dower or curtesy;

**12** (c) To the extent of any interest therein of which the decedent has at any time made a transfer, or with respect to which he has at any time created a trust, in contemplation of or intended to take effect in possession or enjoyment at or after his death (whether such transfer or

trust is made or created before or after the passage of this Act), except in case of a bona fide sale for a fair consideration in money or money's worth. Any transfer of a material part of his property in the nature of a final disposition or distribution thereof, made by the decedent within two years prior to his death without such a consideration, shall, unless shown to the contrary, be deemed to have been made in contemplation of death within the meaning of this title;

**13** (d) To the extent of the interest therein held jointly or as tenants in the entirety by the decedent and any other person, or deposited in banks or other institutions in their joint names and payable to either or the survivor, except such part thereof as may be shown to have originally belonged to such other person and never to have been received or acquired by the latter from the decedent for less than a fair consideration in money or money's worth: *Provided*, That where such property or any part thereof, or part of the consideration with which such property was acquired, is shown to have been at any time acquired by such other person from the decedent for less than a fair consideration in money or money's worth, there shall be excepted only such part of the value of such property as is proportionate to the consideration furnished by such other person: *Provided further*, That where any property has been acquired by gift, bequest, devise, or inheritance, as a tenancy in the entirety by the decedent and spouse, or where so acquired by the decedent and any other person as joint tenants and their interests are not otherwise specified or fixed by law, then to the extent of one-half of the value thereof;

**14** (e) To the extent of any property passing under a general power of appointment exercised by the decedent (1) by will, or (2) by deed executed in contemplation of, or intended to take effect in possession or enjoyment at or after, his death, except in case of a bona fide sale for a fair consideration in money or money's worth; and

**15** (f) To the extent of the amount receivable by the executor as insurance under policies taken out by the decedent upon his own life; and to the extent of the excess over \$40,000 of the amount receivable by all other beneficiaries as insurance under policies taken out by the decedent upon his own life.

#### [Determination of value of net estate.]

**16** **Sec. 403.** That for the purpose of the tax the value of the net estate shall be determined—

**17** (a) In the case of a resident, by deducting from the value of the gross estate—

**18** (1) Such amounts for funeral expenses, administration expenses, claims against the estate, unpaid mortgages upon, or any indebtedness in respect to, property (except, in the case of a resident decedent, where such property is not situated in the United States), losses incurred during the settlement of the estate arising from fires, storms, shipwreck, or other casualty, or from theft, when such losses are not compensated for by insurance or otherwise, and such amounts reasonably required and actually ex-



pended for the support during the settlement of the estate of those dependent upon the decedent, as are allowed by the laws of the jurisdiction, whether within or without the United States, under which the estate is being administered, but not including any income taxes upon income received after the death of the decedent, or any estate, succession, legacy, or inheritance taxes;

**19** (2) An amount equal to the value of any property forming a part of the gross estate situated in the United States of any person who died within five years prior to the death of the decedent where such property can be identified as having been received by the decedent from such prior decedent by gift, bequest, devise, or inheritance, or which can be identified as having been acquired in exchange for property so received: *Provided*, That this deduction shall be allowed only where an estate tax under this or any prior Act of Congress was paid by or on behalf of the estate of such prior decedent, and only in the amount of the value placed by the Commissioner on such property in determining the value of the gross estate of such prior decedent, and only to the extent that the value of such property is included in the decedent's gross estate and not deducted under paragraphs (1) or (3) of subdivision (a) of this section. This deduction shall be made in case of the estates of all decedents who have died since September 8, 1916;

**20** (3) The amount of all bequests, legacies, devises, or transfers, except bona fide sales for a fair consideration in money or money's worth, in contemplation of or intended to take effect in possession or enjoyment at or after the decedent's death, to or for the use of the United States, any State, Territory, any political subdivision thereof, or the District of Columbia, for exclusively public purposes, or to or for the use of any corporation organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, including the encouragement of art and the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private stockholder or individual, or to a trustee or trustees exclusively for such religious, charitable, scientific, literary, or educational purposes. This deduction shall be made in case of the estates of all decedents who have died since December 31, 1917; and

**21** (4) An exemption of \$50,000;

**22** (b) In the case of a nonresident, by deducting from the value of that part of his gross estate which at the time of his death is situated in the United States—

**23** (1) That proportion of the deductions specified in paragraph (1) of subdivision (a) of this section which the value of such part bears to the value of his entire gross estate, wherever situated, but in no case shall the amount so deducted exceed 10 per centum of the value of that part of his gross estate which at the time of his death is situated in the United States;

**24** (2) An amount equal to the value of any property forming a part of the gross estate situated in the United States of any person who died within five years prior to the death of the decedent where such property can be identified as having been received by the decedent from such prior

decendent by gift, bequest, devise, or inheritance, or which can be identified as having been acquired in exchange for property so received: *Provided*, That this deduction shall be allowed only where an estate tax under this or any prior Act of Congress was paid by or on behalf of the estate of such prior decedent, and only in the amount of the value placed by the Commissioner on such property in determining the value of the gross estate of such prior decedent, and only to the extent that the value of such property is included in that part of the decedent's gross estate which at the time of his death is situated in the United States and not deducted under paragraphs (1) or (3) of subdivision (b) of this section. This deduction shall be made in case of the estates of all decedents who have died since September 8, 1916; and

**25** (3) The amount of all bequests, legacies, devises, or transfers, except bona fide sales for a fair consideration, in money, or money's worth, in contemplation of or intended to take effect in possession or enjoyment at or after the decedent's death, to or for the use of the United States, any State, Territory, any political subdivision thereof, or the District of Columbia, for exclusively public purposes, or to or for the use of any domestic corporation organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, including the encouragement of art and the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private stockholder or individual, or to a trustee or trustees exclusively for such religious, charitable, scientific, literary, or educational purposes within the United States. This deduction shall be made in case of the estates of all decedents who have died since December 31, 1917.

**26** No deduction shall be allowed in the case of a nonresident unless the executor includes in the return required to be filed under section 404 the value at the time of his death of that part of the gross estate of the nonresident not situated in the United States.

**27** For the purpose of this title stock in a domestic corporation owned and held by a nonresident decedent shall be deemed property within the United States, and any property of which the decedent has made a transfer or with respect to which he has created a trust, within the meaning of subdivision (c) of section 402, shall be deemed to be situated in the United States, if so situated either at the time of the transfer or the creation of the trust, or at the time of the decedent's death.

**28** The amount receivable as insurance upon the life of a nonresident decedent, and any moneys deposited with any person carrying on the banking business, by or for a nonresident decedent who was not engaged in business in the United States at the time of his death, shall not, for the purpose of this title, be deemed property within the United States.

**29** Missionaries duly commissioned and serving under boards of foreign missions of the various religious denominations in the United States, dying while in the foreign missionary service of such boards, shall not, by reason merely of their intention to permanently remain in such foreign service, be deemed nonresidents of the United States, but shall be presumed to be residents of the State, the District of Columbia, or the Territories of



Alaska or Hawaii wherein they respectively resided at the time of their commission and their departure for such foreign service.

- 30** In the case of any estate in respect to which the tax has been paid, if necessary to allow the benefit of the deduction under paragraphs (2) and (3) of subdivision (a) or (b) the tax shall be redetermined and any excess of tax paid shall be refunded to the executor.

**[Notice and return to be filed by executor.]**

- 31** **Sec. 404.** That the executor, within two months after the decedent's death, or within a like period after qualifying as such, shall give written notice thereof to the collector. The executor shall also, at such times and in such manner as may be required by regulations made pursuant to law, file with the collector a return under oath in duplicate, setting forth (a) the value of the gross estate of the decedent at the time of his death, or, in case of a nonresident, of that part of his gross estate situated in the United States; (b) the deductions allowed under section 403; (c) the value of the net estate of the decedent as defined in section 403; and (d) the tax paid or payable thereon; or such part of such information as may at the time be ascertainable and such supplemental data as may be necessary to establish the correct tax.

- 32** Return shall be made in all cases where the gross estate at the death of the decedent exceeds \$50,000, and in the case of the estate of every nonresident any part of whose gross estate is situated in the United States. If the executor is unable to make a complete return as to any part of the gross estate of the decedent, he shall include in his return a description of such part and the name of every person holding a legal or beneficial interest therein, and upon notice from the collector such person shall in like manner make a return as to such part of the gross estate. The Commissioner shall make all assessments of the tax under the authority of existing administrative special and general provisions of law relating to the assessment and collection of taxes.

**[When Collector shall make the return.]**

- 33** **Sec. 405.** That if no administration is granted upon the estate of a decedent, or if no return is filed as provided in section 404, or if a return contains a false or incorrect statement of a material fact, the collector or deputy collector shall make a return and the Commissioner shall assess the tax thereon.

**[Payment of tax. Extension of time. Penalty.]**

- 34** **Sec. 406.** That the tax shall be due and payable one year after the decedent's death; but in any case where the Commissioner finds that payment of the tax within such period would impose undue hardship upon the estate, he may grant an extension or extensions of time for payment not to exceed three years from the due date.

- 35** The executor shall pay the tax to the collector or deputy collector, and to such portion of the tax, not paid within one year and six months after the decedent's death, interest at the rate of 6 per centum per

annum from the expiration of one year after such death shall be added as part of the tax irrespective of any extension or extensions of time that may have been granted for the payment of the tax, or any portion thereof.

**[Payment of additional tax. Receipts. Discharge of executor from personal liability.]**

**36**     **Sec. 407.** That where the amount of tax shown upon a return made in good faith has been fully paid, or time for payment has been extended, as provided in section 406, beyond one year and six months after the decedent's death, and an additional amount of tax is, after the expiration of such period of one year and six months, found to be due, then such additional amount shall be paid upon notice and demand by the collector, and if it remains unpaid for one month after such notice and demand there shall be added as part of the tax interest on such additional amount at the rate of 10 per centum per annum from the expiration of such period until paid, and such additional tax and interest shall, until paid, be and remain a lien upon the entire gross estate.

**37**     The collector shall grant to the person paying the tax duplicate receipts, either of which shall be sufficient evidence of such payment, and shall entitle the executor to be credited and allowed the amount thereof by any court having jurisdiction to audit or settle his accounts.

**38**     If the executor files a complete return and makes written application to the Commissioner for determination of the amount of the tax and discharge from personal liability therefor, the Commissioner, as soon as possible and in any event within one year after receipt of such application, shall notify the executor of the amount of the tax, and upon payment thereof the executor shall be discharged from personal liability for any additional tax thereafter found to be due, and shall be entitled to receive a receipt or writing showing such discharge: *Provided, however,* That such discharge shall not operate to release the gross estate from the lien of any additional tax that may thereafter be found to be due while the title to such gross estate remains in the heirs, devisees, or distributees thereof; but no part of such gross estate shall be subject to such lien or to any claim or demand for any such tax if the title thereto has passed to a bona fide purchaser for value.

**39**     **Sec. 408.** That if the tax herein imposed is not paid on or before the due date thereof the collector shall, upon instructions from the commissioner, proceed to collect the tax under the provisions of general law, or commence appropriate proceedings in any court of the United States, in the name of the United States, to subject the property of the decedent to be sold under the judgment or decree of the court. From the proceeds of such sale the amount of the tax, together with the costs and expenses of every description to be allowed by the court, shall be first paid, and the balance shall be deposited according to the order of the court, to be paid under its direction to the person entitled thereto.

**40**     If the tax or any part thereof is paid by, or collected out of that part of the estate passing to or in the possession of, any person other than the executor in his capacity as such, such person shall be entitled to



reimbursement out of any part of the estate still undistributed or by a just and equitable contribution by the persons whose interest in the estate of the decedent would have been reduced if the tax had been paid before the distribution of the estate or whose interest is subject to equal or prior liability for the payment of taxes, debts, or other charges against the estate, it being the purpose and intent of this title that so far as is practicable and unless otherwise directed by the will of the decedent the tax shall be paid out of the estate before its distribution. If any part of the gross estate consists of proceeds of policies of insurance upon the life of the decedent receivable by a beneficiary other than the executor, the executor shall be entitled to recover from such beneficiary such portion of the total tax paid as the proceeds, in excess of \$40,000, of such policies bear to the net estate. If there is more than one such beneficiary the executor shall be entitled to recover from such beneficiaries in the same ratio.


### [Tax a lien for ten years.]

**41** **Sec. 409.** That unless the tax is sooner paid in full, it shall be a lien for ten years upon the gross estate of the decedent, except that such part of the gross estate as is used for the payment of charges against the estate and expenses of its administration, allowed by any court having jurisdiction thereof, shall be divested of such lien. If the Commissioner is satisfied that the tax liability of an estate has been fully discharged or provided for, he may, under regulations prescribed by him with the approval of the Secretary, issue his certificate, releasing any or all property of such estate from the lien herein imposed.

**42** If (a) the decedent makes a transfer of, or creates a trust with respect to, any property in contemplation of or intended to take effect in possession or enjoyment at or after his death (except in the case of a bona fide sale for a fair consideration in money or money's worth) or (b) if insurance passes under a contract executed by the decedent in favor of a specific beneficiary, and if in either case the tax in respect thereto is not paid when due, then the transferee, trustee, or beneficiary shall be personally liable for such tax, and such property, to the extent of the decedent's interest therein at the time of such transfer, or to the extent of such beneficiary's interest under such contract of insurance, shall be subject to a like lien equal to the amount of such tax. Any part of such property sold by such transferee or trustee to a bona fide purchaser for a fair consideration in money or money's worth shall be divested of the lien and a like lien shall then attach to all the property of such transferee or trustee, except any part sold to a bona fide purchaser for a fair consideration in money or money's worth.

### [Penalty for failure to file, or for false, notice or return.]

**43** **Sec. 410.** That whoever knowingly makes any false statement in any notice or return required to be filed under this title shall be liable to a penalty of not exceeding \$5,000, or imprisonment not exceeding one year, or both.

**44**  Whoever fails to comply with any duty imposed upon him by section 404, or, having in his possession or control any record, file, or paper, containing or supposed to contain any information concerning the estate

of the decedent, or, having in his possession or control any property comprised in the gross estate of the decedent, fails to exhibit the same upon request to the Commissioner or any collector or law officer of the United States, or his duly authorized deputy or agent, who desires to examine the same in the performance of his duties under this title, shall be liable to a penalty of not exceeding \$500, to be recovered, with costs of suit, in a civil action in the name of the United States.

[Probate proceedings in U. S. Court for China.]

**45**    **Sec. 411.** (a) That the term "resident" as used in this title includes a citizen of the United States with respect to whose property any probate or administration proceedings are had in the United States Court for China. Where no part of the gross estate of such decedent is situated in the United States at the time of his death, the total amount of tax due under this title shall be paid to or collected by the clerk of such court, but where any part of the gross estate of such decedent is situated in the United States at the time of his death, the tax due under this title shall be paid to or collected by the collector of the district in which is situated the part of the gross estate in the United States, or, if such part is situated in more than one district, then the collector of such district as may be designated by the Commissioner.

**46**    (b) For the purpose of this section the clerk of the United States Court for China shall be a collector for the territorial jurisdiction of such court, and taxes shall be collected by and paid to him in the same manner and subject to the same provisions of law, including penalties, as the taxes collected by and paid to a collector in the United States.

**47**    (c) The proviso in the Act entitled "An Act making appropriation for the Diplomatic and Consular Service for the fiscal year ending June 30, 1921," approved June 4, 1920, which reads as follows: "*Provided*, That in probate and administration proceedings there shall be collected by said clerk, before entering the order of final distribution, to be paid into the Treasury of the United States, the same inheritance taxes from time to time collected under the laws enacted by the Congress of the United States from the estates of decedents residing within the territorial jurisdiction of the United States," is hereby repealed.

[Assessment and collection of estate taxes accrued under the Revenue Act of 1918.]

**48**    **Sec. 1400** [of the Revenue Act of 1921]. (a) That the following parts of the Revenue Act of 1918 are repealed, to take effect (except as otherwise provided in this Act) on January 1, 1922, subject to the limitations provided in subdivision (b):

\*           \*           \*           \*           \*

Title IV (called "Estate Tax") on the passage of this Act [i. e., at 3:55 P. M., November 23, 1921];

\*           \*           \*           \*           \*

**49**    (b) The parts of the Revenue Act of 1918 which are repealed by this Act shall (unless otherwise specifically provided in this Act) remain in force for the assessment and collection of all taxes which have



accrued under the Revenue Act of 1918 at the time such parts cease to be in effect, and for the imposition and collection of all penalties or forfeitures which have accrued or may accrue in relation to any such taxes. In the case of any tax imposed by any part of the Revenue Act of 1918 repealed by this Act, if there is a tax imposed by this Act in lieu thereof, the provision imposing such tax shall remain in force until the corresponding tax under this Act takes effect under the provisions of this Act. \* \* \*

### General Administrative Law Provisions.

[Read under Miscellaneous Matters at back of the book.]

50 For ¶50 see page 37.

## ESTATE TAX REGULATIONS, ETC.

TREASURY DEPARTMENT  
INTERNAL REVENUE SERVICE  
Form 706—Revised November, 1922

Collection District .....

To Be Filed in Duplicate

STAMP DATE FILED HERE

## EXTENSIONS OF TIME TO FILE

Time extended to .....

Time extended to .....

Time extended to .....

## RETURN FOR FEDERAL ESTATE TAX.

AN ITEMIZED INVENTORY BY SCHEDULE OF THE GROSS ESTATE OF THE  
DECEDENT, WITH LEGAL DEDUCTIONS.

Decedent's name ..... Date of death ....., 192

Residence at time of death .....

## GENERAL INSTRUCTIONS—READ WITH CARE.

1. **PENALTIES.**—For failure to file return when due, a fine not exceeding \$500, or 25 per cent added to the tax, or both. For knowingly making a false statement in this return, a fine not exceeding \$5,000, or imprisonment, or 50 per cent added to the tax, or any or all of the three. For willfully making a false or fraudulent return, 50 per cent shall be added to the tax. Section 3176, U S Revised Statutes.

2. This return is required for the estate of every resident decedent whose gross estate exceeds \$50,000, and for the estate of every nonresident decedent any part of whose gross estate is situated in the United States. The term "United States" used in this form means only the States, the Territories of Alaska and Hawaii, and the District of Columbia.

3. This return is due one year after the date of death, and must be filed with the collector of the district in which the decedent was domiciled at the time of death, or, in the case of a **NONRESIDENT**, with the Commissioner of Internal Revenue, Treasury Department, Washington, D. C.

4. Regulations No. 63, 1922 Edition, should be carefully studied before making out this return.

5. All papers used in preparing the return should be carefully preserved for reference or inspection. All estate tax returns are verified by an Internal Revenue officer before the tax is determined by the Bureau.

6. If the decedent left a will, a certified copy must be filed in duplicate with the return:

There should be filed in duplicate and as a part of the return such supplemental data and statements as may be necessary to substantiate the return and establish the correct tax.

In the case of the estate of a **NONRESIDENT**, there should be filed—

(1) Certified copy of will, if decedent died testate, or of each will if decedent left more than one, to govern in different jurisdictions.

(2) A certified copy of inventory of the complete gross estate, whether situated within or without the United States. Separate schedules should be made for property within and without the United States, respectively, whether or not deductions are claimed.

(3) If any deduction is claimed, a certified copy of schedule of debts and expenses allowed. If certified copy of inventory of all property outside the United States is filed with the return, such property need not be entered under the respective schedules.

7. This form consists of cover sheets, general information sheet and thirteen schedules. Care should be taken to see that the return is complete and that all schedules are included in the proper order.

The inventory of the gross estate in resident estates must be set forth upon the schedules provided, and should not be attached in the form of an exhibit or separate statement.

8. The questions asked under each schedule should be specifically answered, and if the decedent owned no property of any class specified under the schedule, the word "None" should be written across the schedule.

9. If there is not sufficient space for all entries under any schedule, use additional sheets of the same size, numbering them consecutively as follows: Schedule A-1, A-2, etc., and insert them in the proper order in the return.

10. Where the decedent died from injuries received or disease contracted in line of duty while serving in the military or naval forces of the United States or any country associated with the United States in the prosecution of war against the German Government, or prior to the entrance therein of the United States, see Articles 9 and 10, Regulations No. 63, 1922 Edition.

11. Property identified as received from an estate taxed within five years under the Revenue Act approved September 8, 1916, or subsequent Revenue Acts, or identified as exchanged for such property, must be entered in Schedule G exclusively and not under any other schedule, whether real estate or other property.

12. Property owned jointly or as tenants in the entirety by the decedent and any other person, must be entered in Schedule D under the caption "Jointly Owned Property," and not under any other schedule whether real estate or other property.

13. Further instructions will be found under each schedule. If these instructions are carefully observed, it will greatly assist the estate and the Bureau. Returns not in accordance with the instructions upon this form will not be accepted.

NOTES: RECENT EDITIONS OF THE

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[Front page of Form 706.]

[For use of this Form 706 see ¶196 and ¶205.]

## GENERAL INFORMATION SHEET.

Business address \_\_\_\_\_

Name.	Address.
<p>Names and addresses of physicians and nurses who attended decedent during last illness:</p>	

8-12576







## ESTATE TAX REGULATIONS, ETC.

ESTATE OF

DISTRICT OF \_\_\_\_\_

SCHEDULE B.  
STOCKS AND BONDS.

### INSTRUCTIONS

Give a complete and adequate description of all securities, as follows:

**STOCKS.**—State the number shares, *exact title of corporation*, common or preferred, par value, and quotation at which returned. If a listed security, state principal exchange upon which sold. If unlisted, show the address of the issuing company.

**Examples:** 10 shares American Car & Foundry Co., preferred, par \$100, at 98, New York Exchange.  
10 shares Eagle Manufacturing Co., Red Bank, N. J., common, par \$25, at 30, unlisted.

**BONDS.**—State quantity and denomination, *exact title*, kind of bond, interest rate, interest and due dates. State the exchange upon which listed or the address of company, if unlisted.

Example: Ten \$1,000 Baltimore and Ohio Railway Co. first mortgage 4 per cent registered 50-year gold bonds, due 1948. January, April, July, and October, at 96, New York Exchange.

*Listed stocks and bonds* should be returned at the mean between the highest and lowest quoted selling price upon the date of death, if there were no sales on day of death at the mean between the highest and lowest sales on the nearest date thereto if within a reasonable period; if death occurred on a Sunday or holiday quotations of the nearest previous day should be used; if listed on several exchanges quotations of the principal exchange should be employed.

If actual sales are not available and the stock is quoted on a bid and asked basis, the bid as of date of death should be taken.

*Unlisted securities* which are dealt in actively by brokers or have an active market should be returned at the sale price as of the date of death or the nearest date thereto if within a reasonable period either before or after death. Only sales in the normal course of business should be employed. Where no such sale occurred the nearest bid should be used.

*Inactive stock and stock in close corporations* should be valued upon the basis of the companies' net worth, earning and dividend paying capacity, general market conditions, and special conditions affecting the particular companies, their future prospects, and all other factors having a bearing upon the value of the stock. The financial and other data upon which the estate bases its valuation should be submitted with the return.

Securities returned as of no value, nominal value, or obsolete, should be listed last, and the address of the company and the State and date of incorporation should be stated, if obtainable from the certificate. Copies of correspondence or statements of reasons for return at no value should be retained for inspection.

*Interest on bonds* should be apportioned to the date of death and returned in the interest column. Dividends upon stock declared prior to death, and payable after date of death, must be returned separately unless reflected in the price at which the stock is returned.

*In nonresident estates* the actual depository on date of death of all bonds should be shown and if the inventory of the entire gross estate is filed with the return only bonds actually within the United States and stock of corporations or associations created or organized in the United States should be listed under this schedule.

Paragraph 2 of Article 14, Regulations No. 63, 1922 Edition, should be carefully reviewed before completing this schedule.

Did the decedent own any stocks or bonds? (Answer "Yes" or "No.").....

[illegible]

(Continued on following page.)

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ESTATE OF ..... DISTRICT OF .....

## SCHEDULE B—Continued.

FOR INSTRUCTIONS—SEE PAGE 3

[illegible]

(If more space is needed, insert additional sheets of same size.)

8-12374

B

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[Page 5 of Form 706.]

## ESTATE TAX REGULATIONS, ETC.

ESTATE OF \_\_\_\_\_ DISTRICT OF \_\_\_\_\_

### SCHEDULE C.

MORTGAGES, NOTES, CASH, AND INSURANCE.

### INSTRUCTIONS.

The four classes of property on this schedule should be listed separately in the order given.

MORTGAGES.—State (1) two values and unpaid balance, (2) date of mortgage, (3) name of maker, (4) property mortgaged, (5) interest rates and date of interest. For example: For \$5,000, unpaid balance \$5,000; dated January 1, 1910, John Doe to Richard Roe; premises 22 Clinton St., Newark, N. J.; interest payable at 6 per cent per annum January 1 and July 1; interest paid to January 1, 1912.

NOTES, PROMISSORY.—Give similar data.

**CASH IN POSSESSION.**—List separately from bank deposits.

**CASH IN BANK.**—Name bank and address, amount in each bank and give serial number and nature of account, whether checking, savings, time deposit, etc. Include accrued interest in income column, or indicate if included in total on deposit. If statements are obtained from banks they should be retained for inspection.

**INSURANCE.**—The proceeds of all life insurance to whomsoever payable must be returned regardless of value. Insurance payable to executor must be returned first. State (1) name of company, (2) number of policy, (3) name of person receiving insurance. Include full amount received. All insurance on life of decedent should be entered.

**IMPORTANT:**—If there is insurance payable to beneficiaries other than the executor, deduction may be taken at bottom of this page equal to the amount returned for such insurance, but not exceeding \$40,000.

If decedent was a nonresident, and died subsequent to 3:55 p. m., November 23, 1921, Washington time, insurance on his life need not be included as a part of his gross estate. Neither should bank accounts situated in this country be included where the nonresident decedent died subsequent to said date unless decedent was doing business in the United States. All facts in this connection, however, should be reported whether or not it is contended that the bank account is not taxable.

For further instructions see Articles 27 to 31, inclusive, Regulations No. 63, 1922 Edition.

- (1) Did the decedent, at the time of his death, own any mortgages, notes, or cash? (Answer "Yes" or "No.") \_\_\_\_\_
- (2) Was any insurance on life of decedent receivable by the executor? (Answer "Yes" or "No.") \_\_\_\_\_
- (3) Was any insurance on life of decedent receivable by beneficiaries other than executor? (Answer "Yes" or "No.") \_\_\_\_\_

Item. No.	Description.	Value on day of death.	Income accrued to date of death.
		\$	\$
	TOTAL.....	\$ .....	
	Less amount of insurance receivable by beneficiaries other than the executor not in excess of \$40,000 .....	\$ .....	* * * * *
	TOTAL TAXABLE .....	\$ .....	\$ .....
	GRAND TOTAL .....		\$ .....

(If more space is needed, insert additional sheet of same size.)

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ESTATE OF ..... DISTRICT OF .....

## JOINTLY OWNED PROPERTY.

[illegible]

D













## ESTATE TAX REGULATIONS, ETC.

ESTATE OF \_\_\_\_\_ DISTRICT OF \_\_\_\_\_

## SCHEDULE I.

## DEBTS OF DECEDENT.

### INSTRUCTIONS.

Itemize fully below all valid debts of the decedent due and owing at the time of death. Preserve all vouchers for inspection.

Itemize fully below all valid debts of the decedent due and owing at the time of death. Preserve all vouchers for inspection. If deduction is claimed for a debt, the amount of which is disputed or the subject of litigation, only such amount may be deducted as the estate concedes to be a valid claim. If the claim is contested, that fact should be stated.

Enter notes unsecured by mortgage under this heading and give full details, including name of payee, face and unpaid balance, date and term of note, interest rates and date to which interest was paid prior to death.

Care must be taken to state the exact nature of the claim as well as the name of the creditor. If the claim is for services rendered over a period of time, state the period covered by the claim. Example: January 1, 1919, Edison Electric Illuminating Company for electric service during December, 1918, \$25.

**All Vouchers or Original Records should be preserved for inspection.**

For further instructions see Articles 32, 33, 39, and 40, Regulations No. 63, 1922 Edition

[illegible]

(If more space is needed, insert additional sheets of same size.)

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[Page 13 of Form 706.]





ESTATE OF \_\_\_\_\_ DISTRICT OF \_\_\_\_\_

## PROPERTY IDENTIFIED AS TAXED WITHIN FIVE YEARS.

Enter in this schedule, by separate estates if more than one estate is involved, the total amount deductible as representing property received from an estate taxed within five years or acquired by exchange for property so received.

NOTE.—It is of prime importance to bear in mind that where the estate is entitled to this deduction under the Revenue Act approved February 24, 1919, that is, where the prior decedent died subsequent to October 3, 1917, and the second decedent died subsequent to 6.55 p. m., February 24, 1919, and prior to 3.55 p. m., November 23, 1921, Washington, D. C. time, the right to the deduction is governed by the provisions of that Act. In such case, there may be deducted under this schedule the full value as of the date of the second decedent's death of the property previously taxed and included in Schedule "G" and the full value of property acquired by equal exchange. Where the present decedent gave additional valuable consideration over and above the value of the property, given in exchange, there should be deducted such proportion of the value at date of the present decedent's death of the property acquired in exchange as the value of the original property bore to the entire consideration given. For example, an item of property valued at \$10,000 at the time of the first decedent's death and \$15,000 at the time of the second decedent's death, and which was given by the second decedent to the present decedent's death of the property acquired in exchange should be listed under Schedule "G" and two-thirds of such value deducted under this schedule.

**IMPORTANT**—If the right of deduction is not acquired under the Revenue Act approved February 24, 1919, it is governed by the provisions of the Act approved November 23, 1921, in which the same inactives apply as to Schedule "G," and only the amount of the value of the property previously taxed was included in the prior decedent's gross estate deducted under this schedule, but in no case to exceed the amount of the value of such property as is included in Schedule "G" and not deducted under Schedules "H" to "K" inclusive. This also applies although the property previously taxed was exchanged for other property included in Schedule "G."

For further instructions see Articles 50 *et seq.* and 62, Regulations No. 37, Revised, 1921, and Articles 44 *et seq.* and 56 of Regulations No. 63, 1922 Edition

[illegible]

(If more space is needed, insert additional sheets of same size.)

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(For further deductions under this schedule, see page 16.)

K

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[Page 15 of Form 706.]



# ESTATE TAX REGULATIONS, ETC.

## SCHEDULE L. RECAPITULATION.

Schedule.	Gross estate.	Value.
A	Real estate .....	\$ .....
B	Stocks and bonds .....	.....
C	Mortgages, notes, cash, and insurance .....	.....
D	Jointly owned and other miscellaneous property .....	.....
E	Transfers .....	.....
F	Powers of appointment .....	.....
G	Property identified as taxed within five years .....	.....
	<b>TOTAL GROSS ESTATE</b> .....	\$ .....

Schedule.	DEDUCTIONS.	Amount.
H	Funeral expenses .....	\$ .....
	Administration expenses:	
	Executors' commissions .....	.....
	Attorneys' fees .....	.....
	Miscellaneous .....	.....
I	Debts of decedent .....	.....
J	Unpaid mortgages .....	.....
	Net losses during settlement .....	.....
	Support of dependents .....	.....
K	Property identified as taxed within five years .....	.....
	Charitable, public, and similar bequests .....	.....
	Specific exemption (resident decedents only) .....	*\$50,000
	<b>TOTAL DEDUCTIONS</b> .....	\$ .....

Total gross estate .....	\$ .....
Total deductions .....	.....
<b>NET ESTATE FOR TAX</b> .....	\$ .....

For recapitulation, deductions and net estate for nonresident estates see Schedule M.

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\* If nonresident strike this out.

## ESTATE TAX REGULATIONS, ETC.

## SCHEDULE M.

## DEDUCTIONS—ESTATE OF NONRESIDENT.

If the decedent was not a resident of the United States, Hawaii, or Alaska, no deductions whatever are allowable unless the value of that part of his gross estate situated outside of the United States, Hawaii, or Alaska be set forth. If it be desired to claim deductions, execute Schedules H-I-J-K and compute the deductions allowable as follows:

1. Value of gross estate in United States (Schedules A-B-C-D-E-F-G) .....	\$ .....
2. Value of gross estate outside of the United States (attach itemized schedule showing value) .....	.....
3. Value of total gross estate wherever situated (1 plus 2) .....	.....
4. Gross deductions under Schedules H-I-J .....	.....
5. Net deductions under Schedules H-I-J (that proportion of 4 that 1 bears to 3, not exceeding 10% of 1) .....	.....
6. Schedule K (within the United States) .....	.....
7. Total deductions allowable (5 plus 6) .....	.....
8. Net estate taxable (1 minus 7) .....	.....

## RATES AND TAX DUE.

Net Estate.			DATE OF DEATH .....				Amount of tax.
			(1) Sept. 8, 1916, to Mar. 2, 1917, inclusive.	(2) Mar. 3, 1917, to Oct. 3, 1917, inclusive.	(3) Oct. 4, 1917, to Feb. 24, 1919, inclusive.	(4) On and after Feb. 25, 1919.	
Exceeding—	Not exceeding—	Amount of block.	Rate per cent.	Rate per cent.	Rate per cent.	Rate per cent.	
	\$50,000	\$50,000	1	1½	2	1	\$ .....
\$50,000	150,000	100,000	2	3	4	2	.....
150,000	250,000	100,000	3	4½	6	3	.....
250,000	450,000	200,000	4	6	8	4	.....
450,000	750,000	300,000	5	7½	10	6	.....
750,000	1,000,000	250,000	5	7½	10	8	.....
1,000,000	1,500,000	500,000	6	9	12	10	.....
1,500,000	2,000,000	500,000	6	9	12	12	.....
2,000,000	3,000,000	1,000,000	7	10½	14	14	.....
3,000,000	4,000,000	1,000,000	8	12	16	16	.....
4,000,000	5,000,000	1,000,000	9	13½	18	18	.....
5,000,000	6,000,000	1,000,000	10	15	20	20	.....
6,000,000	7,000,000	1,000,000	10	15	20	20	.....
7,000,000	8,000,000	1,000,000	10	15	20	20	.....
8,000,000	9,000,000	1,000,000	10	15	22	22	.....
9,000,000	10,000,000	1,000,000	10	15	22	22	.....
10,000,000			10	15	25	25	.....
TOTAL TAX .....							\$ .....

M

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[Page 18 of Form 706.]



# ESTATE TAX REGULATIONS, ETC.

## JURAT FOR EXECUTORS AND ADMINISTRATORS.

We-I \_\_\_\_\_  
the undersigned execut. \_\_\_\_\_ administrat. \_\_\_\_\_, do hereby solemnly swear-affirm that on the \_\_\_\_\_ day of \_\_\_\_\_, 192 \_\_\_\_\_, the \_\_\_\_\_ court at \_\_\_\_\_ granted letters testamentary or of administration upon the estate of the foregoing named decedent to \_\_\_\_\_, that \_\_\_\_\_ have made diligent search for property of every kind left by the decedent; that \_\_\_\_\_ have carefully read the instructions printed on this form; that hereon is listed all of the property, tangible and intangible, forming the gross estate of the decedent so far as it has come to \_\_\_\_\_ knowledge and information; that \_\_\_\_\_ have no knowledge of any transfers made or trusts created in contemplation of death or to take effect at or after death, except as stated on Schedule E; that to the best of \_\_\_\_\_ knowledge, information, and belief the value shown for each item of property listed hereon was the actual and full value of the same at the time of decedent's death; and that the debts, expenses, and charges entered hereon as deductions from the gross estate are correct and legally allowable.

## JURAT FOR BENEFICIARIES, CUSTODIANS, AND TRUSTEES.

I-We \_\_\_\_\_  
the undersigned beneficiar. \_\_\_\_\_ Custodian—Trustee, do hereby solemnly swear-affirm that \_\_\_\_\_ have carefully read the instructions printed on this form, that hereon is listed all of the property, tangible or intangible, contained in the gross estate of the decedent which has come into \_\_\_\_\_ possession and control, that to the best of \_\_\_\_\_ knowledge, information, and belief, the value shown for each item of property listed hereon was the actual and full value of the same at the time of the decedent's death; and that the debts, expenses, and charges entered hereon as deductions from the gross estate are correct and legally allowable.

(Name) \_\_\_\_\_

(Address) \_\_\_\_\_

(Name) \_\_\_\_\_

(Address) \_\_\_\_\_

(Name) \_\_\_\_\_

(Address) \_\_\_\_\_

Subscribed and sworn to before me, at \_\_\_\_\_  
this \_\_\_\_\_ day of \_\_\_\_\_, 192 \_\_\_\_\_

Notary Public—Deputy Collector

NOTE.—If there is more than one executor or administrator all must sign and swear to the return.

Attorney's name and address \_\_\_\_\_



THIS COURT ORDERED THAT THE

# THE RECORD

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## ESTATE TAX REGULATIONS, ETC.

TREASURY DEPARTMENT  
INTERNAL REVENUE SERVICE  
Form 704—Revised April, 1922

## PRELIMINARY NOTICE—ESTATE OF RESIDENT

To be filed in duplicate by executor or person in possession of property. (Observe instructions on reverse side.)

District.....

Date filed .....

Name of decedent.....

Date of death.....

Place of death.....

Residence.....

COLLECTOR OF INTERNAL REVENUE,

19.....

I, ....., pursuant to the requirements of section 404 of the Revenue Act of 1921, approved November 23, 1921, hereby give notice that

(Fill in (a) or (b) as facts warrant.)

(a) I qualified as executor.....—administrat.....—of the estate of the above-named decedent in the ..... Court at ..... on the ..... day of ..... 19.....

(b) I had actual or constructive possession of property of the above-named decedent on date of death. The description and approximate value of such property at the time of death were as follows:

Description.	Value.
.....	\$.....
.....	.....
.....	.....

(Attach schedule if more space is required.)

2. To the best of my knowledge the value of the gross estate of the decedent exceeds \$50,000, and the approximate values of the various classes of property comprising the gross estate at date of death were as follows:

Real estate.....	\$.....
Stocks and bonds.....	.....
Miscellaneous personality.....	.....
Property transferred (see Instructions 5 (c)).....	.....
Property owned jointly.....	.....
Life insurance for benefit of estate.....	.....
Other life insurance.....	.....
(Estimated values will be accepted.)	Total.....

That the names and addresses of the legal representatives of the estate and their attorneys insofar as known to me are:

Name..... Address.....

Executors {  
Administrators {  
Attorneys..... {

I HEREBY CERTIFY that I have carefully read the instructions on the reverse side of this form and that all the statements made herein are correct to the best of my knowledge and belief.

3-9928

Signature.....

Designation.....  
(See paragraph 2 of instructions on back.)

Address.....

[Obverse of Form 704.]

[For the use of this Form 704 see ¶187.]



## ESTATE TAX REGULATIONS, ETC.

## INSTRUCTIONS

1. *Estates subject to notice.*—This notice must be filed for the estates of all resident decedents where in any case the value of the gross estate, as defined by the law, exceeds \$50,000.

2. *Persons required to file notice.*—Where an executor or administrator has been appointed by court decree, he must file the notice, which must contain a statement of the value of all the property constituting the gross estate of the decedent. Except as hereinafter mentioned, all persons having actual or constructive possession of any property of the decedent at the time of his death must file this notice. This requirement applies to agents, bankers, brokers, custodians, debtors, factors, fiduciaries, guardians, joint owners, partners, safe-deposit companies, trustees, warehouse companies, and all other persons having possession of property of the decedent. Such persons are relieved of the duty of filing notice only where the executor or administrator has, within the time prescribed, filed a notice including the property in the possession of such persons. In case of doubt, the notice should be filed.

The notice may be executed by one executor or administrator.

3. *Time for filing notice.*—An executor or administrator, appointed by court decree, must file the notice within two months after his qualification. Persons having actual or constructive possession of the property of the decedent, when required to file notice, must file the same within two months after the decedent's death.

4. *Place of filing.*—This notice must be filed with the Collector of Internal Revenue for the district in which the decedent had his domicile at time of death.

5. *Gross estate.*—The gross estate as defined by section 402 of the Revenue Act of 1921, approved November 23, 1921, includes—

- (a) Property which after decedent's death is subject to payment of charges, to expenses of administration, and to distribution as a part of his estate;
- (b) Interest of surviving spouse, as dower, curtesy, or estate in lieu thereof;
- (c) Property transferred or placed in trust in contemplation of, or intended to take effect in possession or enjoyment at or after death.
- (d) Property held jointly or as tenants in the entirety.
- (e) Property passing under a general power of appointment exercised by decedent.
- (f) (1) Insurance payable to a decedent's estate, his personal representatives, or to any person for the benefit of the estate.
- (2) Insurance payable to beneficiaries, other than the estate, in excess of \$40,000.

6. *Lien.*—The tax is a lien for ten years upon the entire gross estate, except such part of it as is used for the payment of charges against the estate and expenses of its administration allowed by any court having jurisdiction.

7. *Penalties.*—The penalty for knowingly making any false statement in this notice is a fine not to exceed \$5,000, or imprisonment, or both. Penalty for failure to file notice as required is a fine not to exceed \$500, and cost of suit.

8. *Delinquency.*—In the event of failure to file this notice within the two months prescribed by law, a detailed explanation under oath should accompany notice when filed.

[Reverse of Form 704.]

## ESTATE TAX REGULATIONS, ETC.

U. S. TREASURY DEPARTMENT  
U. S. INTERNAL REVENUE—ESTATE TAX  
Form 705—Revised July, 1919

## SIXTY-DAY NOTICE—ESTATE OF NONRESIDENT

To be filed in duplicate by executor or person in possession of property. (Observe instructions on reverse side.)

Name of decedent.....  
Date of death.....  
Place of death.....  
Residence.....

COMMISSIONER OF INTERNAL REVENUE,  
Estate Tax Division, Treasury Department,  
Washington, D. C.

I, I., ..... pursuant to the requirements of section 404 of the Revenue Act of 1918, approved February 24, 1919, hereby give notice that I had actual or constructive possession of property or an interest in property which constituted a part of the gross estate situated in the United States of the above-named decedent on date of death, or I came into possession of such property on the ..... day of ....., 19..... The description and approximate value of such property at the time of death were as follows:

Description..... Value.

\$.....

(Attach schedule if more space is required.)

I also have information that property or an interest in property situated in the United States belonging to said decedent was in the possession of others, as shown below:

Name of possessor..... Address..... Description of property.....

2. To the best of my knowledge the value of the gross estate of the decedent situated in the United States is \$..... and the approximate values of the various classes of property comprising such gross estate at date of death were as follows:

Real estate..... \$.....

Stocks and bonds.....

Miscellaneous personalty.....

Property transferred (see Instructions 4 (c)).....

Property owned jointly.....

Life insurance for benefit of estate.....

Other life insurance.....

(Estimated values will be accepted.)

Total.....

That the names and addresses of the legal representatives of the estate and their attorneys insofar as known to me are:

Name..... Address.....

Executor or Administrator { In United States.....  
Outside United States.....

Attorney { In United States.....  
Outside United States.....

I HEREBY CERTIFY that I have carefully read the instructions on the reverse side of this form and that all the statements made herein are correct to the best of my knowledge and belief.

Signature.....

Designation.....  
(See paragraph 2 of instructions on back.)

Address.....

[Obverse of Form 705.]

[For the use of this Form 705 see ¶191.]

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WAR TAX 31 SERVICE



## ESTATE TAX REGULATIONS, ETC.

## INSTRUCTIONS

1. *Estates subject to notice.*—This notice must be filed for the estates of all nonresident decedents having any gross estate, as defined by the law, consisting of property situated in the United States, which includes the States, the Territories of Alaska and Hawaii, and the District of Columbia.

2. *Persons required to file notice and time of filing.*—This notice must be filed by all persons having possession of any property, situated within the United States, which forms part of the gross estate of a nonresident decedent. The notice must be filed within sixty days after receiving information of the decedent's death, or, where possession is acquired after such death, within sixty days after taking possession. This requirement applies to agents, bankers, beneficiaries, brokers, custodians, debtors, factors, fiduciaries, guardians, joint owners, partners, safe-deposit companies, transferees, warehouse companies, and all other persons having possession of property constituting part of the gross estate of the decedent.

3. *Place of filing.*—This notice must be filed with the Commissioner of Internal Revenue, Washington, D. C.

4. *Gross estate.*—The gross estate, as defined by section 402 of the Revenue Act of 1913, approved February 24, 1919, includes:

- (a) Property which after decedent's death is subject to payment of charges, to expenses of administration, and to distribution as a part of his estate.
- (b) Interest of surviving spouse, as dower, courtesy, or estate in lieu thereof.
- (c) Property transferred or placed in trust in contemplation of death or to take effect in possession or enjoyment at or after death.
- (d) Property held jointly or as tenants in the entirety.
- (e) Property passing under a general power of appointment.
- (f) (1) Insurance payable to a decedent's estate, his personal representatives, or to any person for the benefit of the estate.

(2) Insurance payable to beneficiaries in excess of \$40,000.

5. *Property situated in the United States.*—The notice is required only with reference to property situated in the United States. This includes all property, whether real or personal, which is actually situated in this country, including bonds, money on deposit in domestic banks, and debts due by domestic creditors. It also includes stock in domestic corporations, wherever the certificates may be kept, and life insurance payable by domestic insurance companies.

6. *Liability for tax.*—Any person in possession of property which constitutes a part of the estate of a nonresident decedent may be held personally liable for the payment of the estate tax in the event that the property is removed from the jurisdiction of the United States before the tax has been satisfied, or provision made for its payment.

7. *Lien.*—The tax is a lien for ten years upon the entire gross estate, except such part of it as is used for the payment of charges against the estate and expenses of its administration allowed by any court having jurisdiction.

8. *Penalties.*—The penalty for knowingly making any false statement in this notice is a fine not to exceed \$5,000, or imprisonment, or both. Penalty for failure to file notice as required is a fine not to exceed \$500, and cost of suit.

9. *Delinquency.*—In the event of failure to file this notice within the sixty days prescribed by law, a detailed explanation under oath should accompany the notice when filed.

[Reverse of Form 705.]





## INSTRUCTIONS

1. *By whom notice must be filed.*—This notice must be filed by each company, transfer agent, or registrar requested to make transfer of stocks or bonds owned by any person who at the time of death was a nonresident of the United States, and issued by a corporation organized in the United States. The term "United States" means the several States, the Territories of Alaska and Hawaii, and the District of Columbia.

2. *Time of filing.*—This notice must be filed by the company, transfer agent, or registrar within two months following the date of death, or immediately upon receipt of the request for the transfer, unless the transfer is made upon the order of an executor or administrator appointed in the United States.

3. *Place of filing.*—This notice must be filed with the Commissioner of Internal Revenue at Washington, D. C.

4. *Supplemental data.*—Copy of will, inventory, or other documents received with the order for transfer will assist the Bureau of Internal Revenue if submitted with this notice. Transfer of stock should not be made unless notice has been filed with the Commissioner of Internal Revenue and permission to make such transfer has been granted.

2-8945

GOVERNMENT PRINTING OFFICE

[Reverse of Form 714.]

## ESTATE TAX REGULATIONS, ETC.

REGULATIONS 63  
(1922 EDITION)

[Promulgated July 27, 1922. Also designated as T. D. 3384.]

Relating to

## ESTATE TAX

Under the

## REVENUE ACT OF 1921

These regulations apply to the estates of decedents dying after the effective date of Title IV of the Revenue Act of 1921 [i. e. after 3.55 P. M., Washington time, November 23, 1921]. Estate Tax Regulations No. 37 (revised January, 1921) remain in full force and effect, subject to such modifications and changes therein as are specified in Article 106, *infra* [¶254].

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**50 Article 1. The various statutes.**—The Federal estate tax was first imposed by the Act of September 8, 1916. This law was amended by the Act of March 3, 1917 (Title III), and the Act of October 3, 1917 (Title IX). These two statutes increased the rate of tax. The Revenue Act of 1918 (Title IV), which became effective 6.55 p. m., Washington, D. C. time, February 24, 1919, reduced the rates applicable to the smaller net estates as compared with those of Title IX of the Revenue Act of 1917, and contained a number of provisions not found in any of the prior acts. The Revenue



## ESTATE TAX REGULATIONS, ETC.

Act of 1921 (Title IV) became effective at 3.55 p. m., Washington, D. C. time, November 23, 1921. It re-enacts without change the rates of Title IV of the Revenue Act of 1918, supplants all prior acts as to the estates of decedents dying after the effective date thereof, embodies numerous changes, but continues many of the provisions of the earlier acts. It is herein referred to as "the statute." References to other statutes are specific.

**51 Art. 2. Transfers reached.**—The statute subjects to tax transfers by will and under intestate laws, and also transfers made by the decedent in his lifetime, when made in contemplation of death or intended to take effect in possession or enjoyment at or after his death, excepting, however, bona fide sales for a fair consideration in money or money's worth. Transfers of certain other property interests are also included.

**52 Art. 3. Neither a property nor an inheritance tax.**—The Federal estate tax is imposed upon the transfer of the net estate of every person dying after September 8, 1916, determined in the manner prescribed by the applicable law. (See Art. 1.) The tax is not laid upon the property, but upon its transfer from the decedent to others. The subject of tax is the transfer of the entire net estate, not any particular legacy, devise, or distributive share, and the relationship of the beneficiary to the decedent has no bearing upon the question of liability, or the extent thereof. The transfer of property is taxable, although it escheats to the State for lack of heirs.

## ESTATES SUBJECT TO TAX.

**53 Art. 4. Description of taxable estates.**—The tax is imposed upon the transfer of the net estate. The term "net estate" has a distinct meaning in the statute, signifying the difference between the total value of the gross estate and the total of the authorized deductions. One of the deductions authorized in the estate of a resident decedent is the specific sum of \$50,000, and consequently there is no net estate where the gross estate does not exceed that amount. No such deduction is authorized in the estate of a nonresident decedent. (See Arts. 53 to 58, inclusive.)

**54 Art. 5. Definition of "resident" and "nonresident."**—The statute provides (paragraph (5) of section 2) that the term "United States," when used in a geographical sense, includes only the States, the Territories of Alaska and Hawaii, and the District of Columbia.

**55** A resident is one who, at the time of his death, had his domicile in the United States; or one who was a citizen of the United States at time of death and with respect to whose property any probate or administration proceedings are had in the United States Court for China. (See Sec. 411.) A missionary who, at the time of death, was serving as such under a foreign missionary board of any religious denomination in the United States, will be presumed to have died a resident of the United States, if domiciled therein at the time of his or her commission and departure for such service, and not a nonresident merely by reason of his or her intention to permanently remain in such service. (See Sec. 403(b).) Subject to the foregoing exceptions, and the presumption applying in the case of such missionaries, all other persons are nonresidents.

**56** Except as stated above, and in section 400 of the statute in respect to the exemption accorded on account of military or naval service

## ESTATE TAX REGULATIONS, ETC.

in the late war, the statute takes no account of the citizenship of the decedent, but prescribes different rules for the estates of residents and nonresidents.

**57** A citizen of the United States is a nonresident if his domicile is in Porto Rico, the Philippine Islands, or other foreign country, whereas a citizen of a foreign country is a resident if his domicile is in the United States. A person acquires a domicile in a place by living there, for even a brief period of time, with no definite present intention of later removing therefrom. Residence without the requisite intention to remain will not suffice to constitute domicile, nor will intention to change domicile effect such a change unless accompanied by actual removal.

## DETERMINATION OF TAX LIABILITY.

**58** **Art. 6. Manner of determining liability.**—The first step in the determination of tax liability is to ascertain the total value of the decedent's gross estate. (See Arts. 11 to 31, inclusive; also Art. 53.) The second step is to subtract from this value the total deductions authorized in order to arrive at the value of the net estate. (See Arts. 32 to 52, inclusive, as to estates of residents; and Arts. 54 to 58, inclusive, as to estates of nonresidents.) The third step is to obtain the sum of certain percentages of successive portions of the net estate, as provided by the applicable taxing act. (See Arts. 7 and 8.)

**59** **Art. 7. Rates of tax.**—The Revenue Act of 1916, the amendment thereto of March 3, 1917, the Revenue Act of 1917, and the Revenue Act of 1918, each imposed different rates of tax. The rates imposed by the Revenue Act of 1921 are the same as those prescribed in the Revenue Act of 1918. In each act the rates contained therein are applicable to the estates of decedents dying on or after the effective date thereof, and prior to the effective date of the next succeeding act. A table of the several rates is given below:

Rates of estate tax.

Blocks of net estate.			1	2	3	4
Exceeding	Not exceeding	Amount of block.	Act of 1916 (effective Sept. 9, 1916).	Amendment of Mar. 3, 1917 (effective Mar. 3, 1917).	Act of 1917 (effective Oct. 4, 1917).	Acts of 1918 and 1921 (For effective dates, see below.)
			Per cent.	Per cent.	Per cent.	Per cent.
.....	\$50,000	\$50,000	1	1½	2	1
\$50,000	150,000	100,000	2	3	4	2
150,000	250,000	100,000	3	4½	6	3
250,000	450,000	200,000	4	6	8	4
450,000	750,000	300,000	5	7½	10	6
750,000	1,000,000	250,000	5	7½	10	8
1,000,000	1,500,000	500,000	6	9	12	10
1,500,000	2,000,000	500,000	6	9	12	12
2,000,000	3,000,000	1,000,000	7	10½	14	14
3,000,000	4,000,000	1,000,000	8	12	16	16
4,000,000	5,000,000	1,000,000	9	13½	18	18
5,000,000	6,000,000	1,000,000	10	15	20	20
6,000,000	7,000,000	1,000,000	10	15	20	20
7,000,000	8,000,000	1,000,000	10	15	20	20
8,000,000	9,000,000	1,000,000	10	15	22	22
9,000,000	10,000,000	1,000,000	10	15	23	22
10,000,000	.....	.....	10	15	25	25



## ESTATE TAX REGULATIONS, ETC.

- 60** The rates prescribed by the different acts, as set forth above, apply to the estates of decedents dying within the following dates:

Column 1, Revenue Act of 1916, effective Sept. 9, 1916, to Mar. 2, 1917, inclusive.

Column 2, amendment of Mar. 3, 1917, effective Mar. 3, 1917, to Oct. 3, 1917, inclusive.

Column 3, Revenue Act of 1917, effective Oct. 4, 1917, to 6.55 p. m., Washington, D. C., time, Feb. 24, 1919, inclusive.

Column 4, Revenue Act of 1918, effective 6.55 p. m. Feb. 24, 1919, to 3.55 p. m., Nov. 23, 1921 (Washington, D. C., time), on which last named hour and date the revenue Act of 1921, became effective.

- 61** **Art. 8. Computation of tax.**—For the purpose of computing the tax, the net estate is divisible into blocks, each block being taxed at a different and increasing rate. The preceding table gives the amount of the various blocks and the applicable rate of tax under each of the taxing acts. For example, the tax upon the net estate of \$1,240,000 of a decedent dying on March 1, 1919, is computed as follows:

Amount of first block.....	\$50,000 at 1 per cent	\$500
Amount of second block.....	100,000 at 2 per cent	2,000
Amount of third block.....	100,000 at 3 per cent	3,000
Amount of fourth block.....	200,000 at 4 per cent	8,000
Amount of fifth block.....	300,000 at 6 per cent	18,000
Amount of sixth block.....	250,000 at 8 per cent	20,000
Remainder.....	240,000 at 10 per cent	24,000

Total net estate.....1,240,000 Total tax.....75,500

- 62** There is subjoined a table for ascertaining the tax without the detailed computation given above. An illustration of its use is as follows: The net estate of a decedent dying March 1, 1919, amounts to \$1,240,000. By reference to the table it will be seen that the last complete block preceding this amount is \$1,000,000, and that the total tax computed on a million dollars under the rates in force amounts to \$51,500. Upon the remainder of the net estate, \$240,000, the tax is computed at the rate set out in the next following line, or at 10 per cent. The tax on this amount is consequently \$24,000. The following result is thus obtained:

Total tax on.....	\$1,000,000 =	\$51,500
Tax on.....	240,000 =	24,000
Totals.....	\$1,240,000	\$75,500

## ESTATE TAX REGULATIONS, ETC.

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Table for computing estate tax.

Net estate		1		2		3		4	
		Sept. 9, 1916, to Mar 2, 1917 inclusive (Revenue Act of 1916)		Mar. 3, 1917, to Oct. 3, 1917, inclusive (Amendment)		Oct 4, 1917, to 6.55 p. m., Feb. 24, 1919, inclusive (Revenue Act of 1917)		After 6.55 p. m. Feb. 24, 1919 (Revenue Acts of 1918 and 1921).	
Exceeding—	Not Exceeding—	Rate (per cent.).	Tax.	Rate (per cent.).	Total.	Rate (per cent.).	Tax.	Rate (per cent.).	Total.
.....	\$50,000	1	\$500	1½	\$750	2	\$1,000	1	\$1,000
.....	150,000	2	2,000	3	3,000	4	4,000	2	2,000
.....	250,000	3	3,000	4½	4,500	6	6,000	3	3,000
.....	450,000	4	8,000	6	12,000	8	16,000	4	8,000
.....	750,000	5	28,500	7½	22,500	10	30,000	6	18,000
.....	1,000,000	5	41,000	7½	18,750	10	25,000	8	27,000
.....	1,500,000	6	58,000	9	61,500	12	30,000	10	31,500
.....	2,000,000	6	71,000	9	106,500	12	45,000	10	82,000
.....	3,000,000	7	101,000	10½	151,500	14	60,000	12	142,000
.....	4,000,000	7	171,000	12	256,500	16	150,000	14	202,000
.....	5,000,000	8	251,000	13	376,500	18	160,000	16	342,000
.....	6,000,000	8	341,000	13½	511,500	18	180,000	16	502,000
.....	7,000,000	9	441,000	16	661,500	20	200,000	18	682,000
.....	8,000,000	10	641,000	18	811,500	20	200,000	20	882,000
.....	9,000,000	10	100,000	18	150,000	20	200,000	20	1,082,000
.....	1,000,000	10	100,000	18	150,000	22	220,000	20	1,282,000
.....	1,000,000	10	100,000	18	150,000	22	220,000	22	1,502,000
.....	1,000,000	10	100,000	18	150,000	22	220,000	22	1,722,000
.....	1,000,000	10	100,000	18	150,000	25	250,000	22	1,942,000
.....	1,000,000	10	100,000	18	150,000	25	250,000	25	2,162,000
.....	1,000,000	10	100,000	18	150,000	25	250,000	25	2,382,000
.....	1,000,000	10	100,000	18	150,000	25	250,000	25	2,602,000
.....	1,000,000	10	100,000	18	150,000	25	250,000	25	2,822,000
.....	1,000,000	10	100,000	18	150,000	25	250,000	25	3,042,000
.....	1,000,000	10	100,000	18	150,000	25	250,000	25	3,262,000
.....	1,000,000	10	100,000	18	150,000	25	250,000	25	3,482,000
.....	1,000,000	10	100,000	18	150,000	25	250,000	25	3,702,000
.....	1,000,000	10	100,000	18	150,000	25	250,000	25	3,922,000
.....	1,000,000	10	100,000	18	150,000	25	250,000	25	4,142,000
.....	1,000,000	10	100,000	18	150,000	25	250,000	25	4,362,000
.....	1,000,000	10	100,000	18	150,000	25	250,000	25	4,582,000
.....	1,000,000	10	100,000	18	150,000	25	250,000	25	4,802,000
.....	1,000,000	10	100,000	18	150,000	25	250,000	25	5,022,000
.....	1,000,000	10	100,000	18	150,000	25	250,000	25	5,242,000
.....	1,000,000	10	100,000	18	150,000	25	250,000	25	5,462,000
.....	1,000,000	10	100,000	18	150,000	25	250,000	25	5,682,000
.....	1,000,000	10	100,000	18	150,000	25	250,000	25	5,902,000
.....	1,000,000	10	100,000	18	150,000	25	250,000	25	6,122,000
.....	1,000,000	10	100,000	18	150,000	25	250,000	25	6,342,000
.....	1,000,000	10	100,000	18	150,000	25	250,000	25	6,562,000
.....	1,000,000	10	100,000	18	150,000	25	250,000	25	6,782,000
.....	1,000,000	10	100,000	18	150,000	25	250,000	25	7,002,000
.....	1,000,000	10	100,000	18	150,000	25	250,000	25	7,222,000
.....	1,000,000	10	100,000	18	150,000	25	250,000	25	7,442,000
.....	1,000,000	10	100,000	18	150,000	25	250,000	25	7,662,000
.....	1,000,000	10	100,000	18	150,000	25	250,000	25	7,882,000
.....	1,000,000	10	100,000	18	150,000	25	250,000	25	8,102,000
.....	1,000,000	10	100,000	18	150,000	25	250,000	25	8,322,000
.....	1,000,000	10	100,000	18	150,000	25	250,000	25	8,542,000
.....	1,000,000	10	100,000	18	150,000	25	250,000	25	8,762,000
.....	1,000,000	10	100,000	18	150,000	25	250,000	25	8,982,000
.....	1,000,000	10	100,000	18	150,000	25	250,000	25	9,202,000
.....	1,000,000	10	100,000	18	150,000	25	250,000	25	9,422,000
.....	1,000,000	10	100,000	18	150,000	25	250,000	25	9,642,000
.....	1,000,000	10	100,000	18	150,000	25	250,000	25	9,862,000
.....	1,000,000	10	100,000	18	150,000	25	250,000	25	10,082,000



## ESTATE TAX REGULATIONS, ETC.

## EXEMPT ESTATES—SERVICE IN WORLD WAR.

**64** Art. 9. Exempt estates.—The first exemption from estate tax, on  
8 account of military or naval service in the war against Germany, was contained in the Revenue Act of 1917, and applied to the estate "of any decedent dying while serving in the military or naval forces of the United States, during the continuance of the war in which the United States is now engaged, or if death results from injuries received or disease contracted in such service, within one year after the termination of such war," and was limited to the increased rates of tax imposed thereby, and to the estates of decedents dying after its passage.

**65** In the Revenue Act of 1918 the exemption was extended to include the estate "of any decedent who has died or may die while serving in the military or naval forces of the United States in the present war or from injuries received or disease contracted while in such service," and embodied a retroactive provision rendering the exemption available under the former Acts, and authorized the refund of taxes collected under the provisions thereof from estates to which the exemption applied. Where such taxes have been paid or collected, a claim for refund on Form 843 should be filed accompanied by such of the proofs prescribed in Article 10 as may be applicable to the particular case. (See Arts. 63 and 96.)

**66** The Revenue Act of 1921 exempts from tax the estates of two classes of decedents, namely: (1) Where the decedent died from injuries received or disease contracted in line of duty while serving in the military or naval forces of the United States in the war against the German Government. The term "military or naval forces of the United States" includes, among other units, the Marine Corps, the Coast Guard, the Army Nurse Corps, Female, and the Navy Nurse Corps, Female; but does not include personnel of the Public Health Service. (2) Where the decedent, a citizen of the United States, enlisted in the military or naval forces of any country associated with the United States in the prosecution of such war, and whose death resulted from injuries received or disease contracted in line of duty while serving in such forces, either prior to the entrance of the United States into such war, or during the time such country was associated with the United States in the prosecution thereof. The estate of such a decedent is not deprived of the benefit of this exemption by reason of the fact that, as a condition precedent to his enlistment in the military or naval forces of any such country, the decedent was required to take an oath of allegiance to such country or to the reigning sovereign thereof. Under the retroactive provision of this Act the exemption, as will be noted, is made available to the estates of those whose deaths resulted from injuries received or disease contracted "in line of duty" while serving, as above set out, in the military or naval forces of such a foreign country. The exemption is conditioned, both with respect to service in the military or naval forces of the United States and such a foreign country, upon death resulting from injuries received or disease contracted "in line of duty;" a condition which, in all cases, operates wherever the death occurred subsequent to the effective date of this Act. (See Art. 1.) The Act contains a refundment clause similar to that in the Revenue Act of 1918. (See Arts. 63 and 96.)

**67** As to the United States, and so far as concerns the provisions of the various Revenue Acts imposing an estate tax, such war terminated March 3, 1921, by virtue of the joint resolution of Congress approved on that date.

## ESTATE TAX REGULATIONS, ETC.

**68** **Art. 10. Exemption must be proved.**—In every case where the exemption is claimed the right must be proved by the estate. Formal claim for exemption on Form 793, accompanied by supporting evidence, should be filed with the notice required by section 404 (see Art. 63), or as soon thereafter as the necessary evidence may be secured, and in any case not later than one year after the decedent's death. Where decedent died before his discharge from the military or naval forces of the United States, and it is claimed that his death resulted from injuries received or disease contracted in line of duty during the war with Germany, there should be submitted:

(1) In the case of a soldier, a certificate of the Adjutant General of the Army; in the case of a sailor, a certificate of the Surgeon General of the Navy; in the case of a Marine, a certificate of the Commandant of the Marine Corps; and in the case of a person who served in any auxiliary force comprehended within the term "military or naval forces of the United States," a certificate of the proper authority, showing the occurrence of death while in the service, and whether, by the official records, it resulted from injuries received or disease contracted in line of duty during such war.

(2) In the event that the official records do not disclose all the pertinent facts, then affidavits of officers or enlisted men will be considered in connection with such records as to the incurrence of injury or disease in line of duty during such war.

**69** Where the decedent died after discharge from the military or naval forces of the United States, there should be submitted:

(1) Certificate of discharge from the service, or a duly verified copy of such certificate.

(2) Certified copy of public record of death, showing cause of death.

(3) Affidavit or affidavits of the attending physician or physicians, setting forth decedent's medical history while under the treatment of such physician or physicians.

(4) Affidavits of officers or enlisted men or other evidence bearing upon the question whether death resulted from injuries received or disease contracted in line of duty while serving in the military or naval forces of the United States during such war.

**70** Where it is claimed that the decedent, a citizen of the United States who enlisted in the military or naval forces of any country associated with the United States in the prosecution of such war, died from injuries received or disease contracted in line of duty while in such foreign service, as more fully explained in the third paragraph of this article, there shall be submitted:

(1) Evidence showing his citizenship at the time of such enlistment.

(2) A complete copy of the official records of his service in the forces of the foreign country, certified by the custodian thereof.

**71** Where, in any case, it is determined by the Commissioner that the estate is entitled to the exemption, the executor will be notified to that effect, and his duties with respect to the tax will cease. If the evidence submitted in support of the claim is found not to be satisfactory, such further evidence will be called for, or such investigation instituted, as the Commissioner may direct. If it is determined that the estate is not entitled to the exemption, the executor will be required to file return and pay tax in the same manner as executors of other taxable estates.



## GROSS ESTATE—GENERAL.

**72** **Art. 11. Character of interests included.**—It is designed by the foregoing provision of the statute that there shall be included in the gross estate the value of all property of the decedent whether real or personal, tangible or intangible, the beneficial ownership of which was in the decedent in his lifetime, and which, upon his death, formed his estate.

**73** The test which determines whether the value of a given interest is to be so included, pursuant to the foregoing provision of the statute, is that stated therein which requires that the property, after death, shall be subject to: (1) payment of the charges against the estate, (2) payment of the expenses of administration, and (3) distribution as a part of the estate.

**74** The value of a vested remainder should be included in the gross estate. Nothing should be included, however, on account of a contingent remainder where the contingency does not happen in the lifetime of the decedent, and the interest consequently lapses at his death. Nor should anything be included on account of an interest or an estate limited for the life of the decedent. There should be included, however, the value of an annuity payable to, or an interest or an estate vested in, the decedent for the life of another person who survives him. For rules in valuing such remainders, annuities, and interests or estates *pur autre vie*, see Article 15.

**75** **Art. 12. Specific property to be included.**—The value of all real property situated in the United States, and owned by the decedent at the date of his death, should be included in the gross estate, whether the decedent was a resident or a nonresident, and whether the property came into the possession and control of the executor or administrator or passed directly to heirs or devisees. The value of real property situated outside the United States should not be included, except as otherwise provided in Articles 55, 56, and 57, where deductions from gross estate are claimed and the decedent was a nonresident. Where the decedent was a resident, the value of all personal property owned by him should be included, wherever situated. Where decedent was a nonresident, the value of so much of his personal property as had its situs in the United States at the time of his death should be included, and the value of his entire gross estate, wherever situated, if deductions are claimed. (See Arts. 55, 56, and 57.) As to the situs of the personal property of nonresident decedents, see Article 53.

**76** A cemetery lot owned by the decedent is part of his gross estate, but its value is limited to the salable value of such part of it as is not designed for the interment of the decedent or members of his family. Rents and interest which had accrued at the time of the decedent's death, whether then payable or not, and unpaid matured coupons, should be included. The value of notes or other claims held by the decedent should be included, though they are canceled by his will. As to the valuation of notes and claims, see Article 14, paragraphs 4 and 7. All bonds, whether federal, state, or municipal, and whether or not containing a tax-free covenant, should be included.

[Value of U. S. bonds not to be excluded, ¶307.]

[Value of state and municipal bonds not to be excluded, ¶423.]

**77** Dividends on either common or preferred stock should be included only where declared prior to the decedent's death and not reflected in the market value of the stock on the day of death. Thus dividends, both declared and payable to holders of record on a date prior to the decedent's death, should be included, provided the stock was selling "ex-dividend" on the date of death.

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**78** Example: A 5 per cent dividend upon stock is declared March 1, payable on April 1 to stockholders of record on March 15. If the death occurred on March 10 and the market value on that day was 90, the value to be returned for both stock and dividend is 90, the dividend being reflected in the market value of the stock. If the death occurred on March 20, the dividend is not reflected in the market value, and must be returned in addition to the market value of the stock on March 20.

**79** **Art. 13. Value.**—Property of the decedent should be returned at its market or sale value at the time of the decedent's death. The criterion of such value is the price which a willing buyer will pay to a willing seller for the property in question under the circumstances existing at the date of the decedent's death or within such reasonable period thereafter as would afford proper opportunity for an examination and sale thereof. Neither depreciation nor appreciation in value subsequent to the date of decedent's death is considered.

**80** **Art. 14. Rules for the valuation of property.**—(1) **Real estate.**—Where real property has been sold, the amount received will be taken as its value provided the sale met the conditions laid down in Article 13. Where no sale has been made, the criterion of value is the best price which could have been obtained within a reasonable period of the decedent's death. The property should not be returned at the local assessed value thereof unless such value represents the true market value at the date of decedent's death. All relevant facts and all elements of value should be considered in every case.

**81** (2) **Stocks and bonds.**—The value of stocks and bonds listed upon a stock exchange should be determined by taking the mean between the highest and lowest quoted selling price upon the date of death. If there were no sales on the date of death the value should be determined by taking the mean between the highest and lowest sales upon the nearest date either before or after the date of death if within a reasonable period. If the decedent died on a Sunday or holiday, the transaction of the next previous business day will govern. If the security is listed upon more than one exchange, the records of the principal exchange should be employed. In general, in valuing listed stocks and bonds the executor should observe care to consult accurate records to obtain value as of the date of death.

**82** If the securities are not listed upon an exchange but are dealt in actively by brokers or have an active market, the value should be determined by taking the sale price as of the date of death or of the nearest date thereto if within a reasonable period. Securities which are not dealt in actively enough to establish market value clearly but in which there are occasional transactions should be valued upon the basis of the nearest sales to the date of death, provided such sales were in the normal course of business, between a willing buyer and a willing seller who were trying to make the best bargain possible. Where quotations are obtained from brokers or where evidence as to the sale of securities is obtained from the officers of the issuing companies, the executor is requested to preserve in his files the letters furnishing quotations for inspection when the return is verified by an investigating officer.

**83** Where securities are actively quoted on a bid and asked basis and actual sales are not available, the bid price as of the date of death



## ESTATE TAX REGULATIONS, ETC.

will be accepted as the value. In the case of corporate and other bonds where there is no active market, the value is to be determined by giving consideration to the soundness of the security, the interest yield, the date of maturity, and any other relevant factors.

**84** Where there is no active market for the stock or securities (whether listed or unlisted) owned by the estate, or where the sales thereof made from time to time are seriously disproportionate in number of shares sold to the holdings of the decedent, and the executor proceeds in good faith promptly and within a reasonable time to make a bona fide sale or sales of any of such stocks or securities, the amount so realized will be accepted as the value. Sales, however, of only a few shares out of a large holding, or sales made without a real effort to secure the widest market possible, or sales made merely for the purpose of fixing value will not be considered as conclusive.

**85** If in connection with the value of any particular security conditions of sale or ownership are such that the market value determined as indicated above would not afford a proper basis for the valuation of the decedent's securities, the Commissioner on final audit will establish the value by considering all other factors relating to the case. In any case where the estate contends that the value as established by the general rules stated above is not the fair market value for the security owned by the decedent on the date of his death, the evidence upon which it bases its contention should be filed with the return.

**86** Stock in corporations where there have been no bona fide sales within a reasonable period of a number of shares fairly comparable to the decedent's holdings should be valued at what a willing buyer would pay to a willing seller, both being fully informed of the financial condition of the company at the date of death.

**87** Where the decedent's holdings are relatively small, a copy of the balance sheet of the corporation nearest to the date of the decedent's death and a statement of the earnings and dividends for the five years preceding death should be submitted in duplicate with the return wherever practicable. Where the decedent's holdings are relatively large, and it is practicable to do so, the fullest financial data should be submitted in duplicate with the return, including in particular balance sheets of the corporation for the five years preceding death, a statement of the net earnings and dividends paid by the company over this period or over a sufficient number (either greater or less) of years prior to the decedent's death to demonstrate the normal earning capacity of the corporation, and a summary of the market conditions and future prospects of the company at the date of the decedent's death, together with a statement showing the relation, if any, of the decedent to the actual operation of the company, the effect of his death thereon, and any and all other factors which may have a bearing upon the value of the stock. Where examinations of a company have been made by accountants, engineers, or other technical experts as of or about the date of death, copies of their reports should be filed with the return where they can be obtained without undue trouble or expense to the estate. In general, the estate should show the basis of its return and submit any financial data that will enable the commissioner accurately and intelligently to review the case.

**88** The full value of securities pledged to secure a loan should be included in the gross estate. If the decedent had a trading account

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with a broker, all securities belonging to the decedent and held by the broker at the date of death must be included at their market value on that date. Securities purchased on margin for the decedent's account and held by the broker should also be returned at their market value on the date of death. The amount of the decedent's indebtedness to the broker, or other person with whom the securities were pledged, will be allowed as a deduction from the gross estate. (See Art. 39.)

**89** (3) **Interest in business.**—Care should be taken to arrive at an accurate valuation of any business in which the decedent was interested, whether as partner or proprietor. A fair appraisal as of the date of death should be made of all the assets of the business, tangible and intangible, and the business should be given a net worth equal to the amount which a purchaser, whether an individual or corporation, would be willing to pay therefor at a normal sale in view of the net value of the assets and the demonstrated earning capacity. Special attention should be given to fixing an adequate figure for the value of the good will of the business in all cases where the decedent has not, for a fair consideration in money or money's worth, agreed that his interest therein shall pass at his death to his surviving partner or partners.

**90** In general, the rules stated above relative to the valuation of other property are applicable to the valuation of an interest as proprietor or partner in a business, and all evidence bearing upon such valuation should be submitted with the return, including copies of reports in any case where examinations of a business have been made by accountants, engineers, or other technical experts as of or about the date of decedent's death.

**91** (4) **Notes, secured and unsecured.**—The value of notes, whether secured or unsecured, will be presumed to be the amount of unpaid principal, plus accrued interest to the date of decedent's death, unless the executor establishes the right to return them at a lower value, or as worthless. To establish such a right it must be shown by satisfactory evidence that the note, either in whole or in part, is uncollectible by reason of the insolvency of the party or parties liable, or for other cause, and that the property, if any, pledged or mortgaged as security is insufficient to satisfy it.

**92** (5) **Cash on hand or on deposit.**—The amount of cash belonging to the decedent, either in his possession at the date of death or in the possession of another, should be included. Bank accounts should be returned in the amount on deposit to the credit of the decedent at the date of death. If checks then outstanding, given in discharge of bona fide, legal obligations of the decedent, and not as transfers coming within the provisions of section 402 (c), are subsequently honored by the bank and charged to the account, the balance remaining may be returned, provided the payments effected thereby are not claimed as deductions from the gross estate. Interest which the bank agreed to pay upon condition that the money remain on deposit for a period of time which expired subsequent to the decedent's death, should not be included.

**93** (6) **Patents, trade-marks, and copyrights.**—The basis for valuation of an intangible asset of this character is the present worth of the estimated future earnings of the exclusive right during the rest of its existence. The return received by the decedent should be considered in estimating future earnings.



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**94** (7) **Accounts receivable, claims, judgments, etc.**—A fair valuation for assets of this character at the time of death should be fixed by the executor according to the best information available to him at the time of making return. A right of action which terminated with the death of the decedent should not be included in the gross estate.

**95** (8) **Other property.**—With respect to all other property, excepting household and personal effects, concerning which see paragraph (9) of this article, the executor should ascertain and return the fair market value thereof as of the day of decedent's death. As to property sold subsequent to death, see Article 13. Live stock, farm machinery, harvested and growing crops, where of an aggregate value of \$2,000 or more, should be valued, as of the date of decedent's death, by one or more competent and disinterested appraisers, and their itemized appraisal thereof in writing, verified by the oath of each, should be filed in duplicate with the return on Form 706. The executor should also file in duplicate with the return his affidavit as to the completeness of the itemized lists of such property and of the disinterested character and qualifications of the appraiser or appraisers.

**96** (9) **Household and personal effects—General provisions.**—Executors and administrators are required to have careful appraisal made of all household and personal effects of the decedent by one or more competent and disinterested appraisers, except as otherwise provided in subdivision (a) of this paragraph, and the appraisal thereof, reduced to writing and verified by the oath or oaths of the appraiser or appraisers, should be filed in duplicate with the return on Form 706, accompanied by the affidavit in duplicate of the executor as to the completeness of the itemized lists of such property and of the disinterested character and qualifications of the appraiser or appraisers. Where it is desired to effect distribution or sale of any portion of such property in advance of an investigation by a special officer of the Bureau of Internal Revenue, as provided in Article 72, notice thereof should be given to the Internal Revenue Agent in Charge for the Division wherein the decedent was domiciled at the date of his death, or, if such household and personal effects be not located in such Division, then to the Commissioner. If the return has not been filed, the notice should be accompanied by a verified appraisal of such property, and an affidavit of the executor as provided above. If personal inspection by a special officer of the Bureau is not deemed necessary the executor will be so advised. This procedure is designed to facilitate disposition of such property and to obviate future expense and inconvenience to the estate by affording the Commissioner an opportunity to make an investigation, should one be deemed necessary, prior to the sale or distribution. (For location of the officers of the several Internal Revenue Agents in Charge, and the territory embraced in their Divisions, respectively, see Appendix [¶777, herein].)

**97** (a) **When value is less than \$2,000.**—When the value of the personalty involved is less than \$2,000, the detailed lists may be prepared by the executor personally. A room by room appraisal is desirable; and all the articles should be named specifically, except those of small value, such as common bric-a-brac or cheap books. A separate value should be given for each article named, except that the values of a number of articles contained in the same room may be grouped. The value of an article worth more than \$50 should be stated separately. Such an entry as the following would be acceptable:

**98** Dining room: Table, six chairs, three pictures (common prints), value \$75; sideboard, \$60; total, \$135.



## ESTATE TAX REGULATIONS, ETC.

**99** If there should be included in the lot, however, jewelry or silverware of more than ordinary value, or articles having a marked artistic value, the executor must furnish an appraisal by a person or persons thoroughly qualified by training and experience to judge of the value of such articles.

**100** In the case of effects having a total value of less than \$2,000, the executor may furnish, as an alternative requirement, a sworn statement in duplicate of the aggregate total value of the property by a professional appraiser or appraisers of recognized standing and ability, or by a dealer or dealers in the class of personalty involved.

**101 (b) When value is more than \$2,000.**—When the value of the effects is more than \$2,000, detailed lists must be furnished, prepared by an appraiser or appraisers of recognized competence, or by a dealer or dealers in the particular classes of personalty involved. The lists must be prepared in the same detail as that indicated above for the executor's list. Where the personalty includes jewelry, silverware, or like articles, except in cases where the value of these items is insignificant, the appraisal of a reputable dealer or appraiser of jewelry must be furnished.

**102** In the case of articles having marked artistic value, such as paintings, engravings, etchings, statuary, vases, oriental rugs, or antiques, the appraisal of an expert or experts will be required. A description of such articles should be fully given. Where paintings having artistic value are listed, the size, subject, and artist's name should be stated. In the case of oriental rugs, the size, make, and general condition should be given. The weight in ounces of silverware should be stated.

**103 (c) Appraisers and basis of appraisals.**—Where expert appraisers are to be employed, care should be taken to see that they are men of recognized competence with respect to the particular class of property involved. In order to facilitate the acceptance of the appraisal, appraisers should be employed whose competence is well established.

**104** The value to be arrived at in appraising articles of this character is the fair market value on date of decedent's death. Where property is valued by legatees for purposes of distribution, such value will not necessarily be accepted. The original cost of the articles is not necessarily a proper basis, on account of depreciation or appreciation in value.

[See further at ¶256 for "Household effects and like personalty."]

**105 Art. 15. Valuation of annuities, and of life and remainder interests.**

—Where the decedent was entitled to receive an annuity of a definite amount during the lifetime of another person, its present worth at the time of the decedent's death must be computed upon the basis of the expectancy of life of the other person. The table marked "A," a part of this Article, should be used for this computation. The amount payable annually should be multiplied by the figure in column 2 of the table opposite the number of years in column 1 nearest to the actual age of the other person.

**106 Example:** The decedent received under the terms of his father's will an annuity of \$10,000 for the life of his elder brother. The brother at the decedent's death was 40 years 8 months old. By reference to the table the figure in column 2 opposite 41 years, the number nearest to the brother's age, is found to be 14.86102. The present worth of the annuity is therefore \$148,610.20.

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**107** Where the decedent was entitled to receive the annuity during a specified number of years, the table marked "B," a part of this article should be used.

**108** Example: The decedent received under the terms of his father's will an annuity of \$10,000 for a period of 20 years, 15 of which had expired at the decedent's death. By reference to the table it is found that the figure in column 2 opposite 5 years, the unexpired portion of the 20-year period, is 4.45182. The present worth of the annuity is, therefore, \$44,518.20 (4.45182 multiplied by 10,000).

**109** Where the decedent was entitled to receive the entire income of certain property during the life of another person, or for a term of years, and the annual rate of income for a period equal to or exceeding the life expectancy of such other person or such term of years, is fixed or definitely determinable at the time of the decedent's death, then the present worth of decedent's right to such income should be computed as explained above in the case of an annuity.

**110** Example: The decedent's father placed \$100,000 in trust, with directions that it be invested in state and municipal bonds and the entire income paid to the decedent during the life of his elder brother, who was 41 years old at the decedent's death. Before the decedent's death the money was invested in state and municipal bonds maturing at dates beyond such elder brother's life expectancy, and yielding annually an income of \$5,000. In this case the rate of income is definitely determinable. By reference to the table, it is found that the present worth of an income of \$5,000, dependent upon the life of a person 41 years of age, is \$74,305.10 (14.86102 multiplied by 5,000).

**111** Where the rate of annual income is not determinable, or where the decedent was entitled merely to the personal use of nonincome-bearing property, a hypothetical annuity at a rate of 4 per cent of the value of the property should be made the basis of the calculation.

**112** Example: The decedent died before a fund of \$100,000, of which he was entitled to receive the income during the life of a person 41 years old, had been invested by the trustees. The value of a hypothetical annuity of \$4,000, dependent upon the life of such a person, is indicated by the table to be \$59,444.08 (14.86102 multiplied by 4,000).

**113** Where the decedent had a remainder interest in property subject to the life estate of another, and such interest constituted an asset of his estate, the present worth of the remainder interest at the time of death should be obtained by multiplying the value of the property at the time of death by the figure in column 3 of Table A opposite the number of years nearest to the age of the life tenant. Where the remainder interest is subject to an estate for a term of years Table B should be used.

**114** Example: The decedent was entitled to receive property worth \$50,000 upon the death of his elder brother, to whom the income for life had been bequeathed. The brother at the time of the decedent's death was 31 years old. By reference to the table it is found that the figure in column 3 opposite 31 years is 0.31262. The present worth of the remainder interest is, therefore, \$15,631.



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## TABLE "A."

Table, single life, 4 per cent, showing the present worth of an annuity, or life interest, and of a reversionary interest.

1	2	3	1	2	3
Age	Annuity, or present value of \$1 due at the end of each year during the life of a person of specified age	Reversion, or present value of \$1 due at the end of the year of death of a person of specified age	Age	Annuity, or present value of \$1 due at the end of each year during the life of a person of specified age	Reversion, or present value of \$1 due at the end of the year of death of a person of specified age
	<i>Annuity</i>	<i>Reversion</i>		<i>Annuity</i>	<i>Reversion</i>
0	\$14.72829	\$0.39507	51	\$12.17919	\$0.49311
1	17.30771	.20586	52	11.88408	.50446
2	18.69578	.24247	53	11.58531	.51595
3	19.15901	.22465	54	11.28325	.52757
4	19.41226	.21491	55	10.97789	.53931
5	19.55301	.20950	56	10.66982	.55116
6	19.61731	.20703	57	10.35931	.56310
7	19.62502	.20673	58	10.04630	.57514
8	19.61097	.20727	59	9.73131	.58726
9	19.53413	.21022	60	9.41474	.59943
10	19.45359	.21332	61	9.09765	.61163
11	19.36943	.21656	62	8.78052	.62383
12	19.28184	.21993	63	8.46412	.63600
13	19.19065	.22344	64	8.14858	.64812
14	19.09590	.22708	65	7.83552	.66017
15	18.99764	.23086	66	7.52476	.67212
16	18.89569	.23473	67	7.21699	.68397
17	18.79010	.23884	68	6.91298	.69565
18	18.68070	.24305	69	6.61301	.70719
19	18.56751	.24740	70	6.31716	.71857
20	18.45038	.25191	71	6.02612	.72976
21	18.32932	.25656	72	5.74003	.74077
22	18.20416	.26138	73	5.45928	.75157
23	18.07471	.26636	74	5.18402	.76215
24	17.94097	.27150	75	4.91463	.77251
25	17.80274	.27682	76	4.65125	.78264
26	17.65984	.28231	77	4.39383	.79254
27	17.51224	.28799	78	4.14286	.80220
28	17.35968	.29386	79	3.89858	.81159
29	17.20225	.29991	80	3.66071	.82074
30	17.03961	.30617	81	3.42900	.82965
31	16.87176	.31262	82	3.20258	.83836
32	16.69846	.31929	83	2.98024	.84691
33	16.51964	.32617	84	2.76106	.85534
34	16.33503	.33327	85	2.54366	.86371
35	16.14437	.34060	86	2.32795	.87200
36	15.94755	.34817	87	2.11384	.88024
37	15.74427	.35599	88	1.90115	.88842
38	15.53421	.36407	89	1.69107	.89650
39	15.31722	.37241	90	1.48540	.90441
40	15.09295	.38104	91	1.28432	.91214
41	14.86102	.38996	92	1.09024	.91961
42	14.62122	.39918	93	.90647	.92667
43	14.37356	.40871	94	.73687	.93320
44	14.11860	.41852	95	.58435	.93906
45	13.85713	.42857	96	.46182	.94378
46	13.58958	.43886	97	.36698	.94742
47	13.31698	.44935	98	.24038	.95229
48	13.03942	.46002	99	.00000	.96154
49	12.75716	.47088			
50	12.47032	.48191			



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TABLE B.

Table, single life, 4 per cent, showing the present worth of an annuity, or life interest, and of a reversionary interest—Continued.

1	2	3	1	2	3
Number of years	Present worth of an annuity of \$1, payable at the end of each year, for a certain number of years	Present worth of \$1, payable at the end of a certain number of years	Number of years	Present worth of an annuity of \$1, payable at the end of each year, for a certain number of years	Present worth of \$1, payable at the end of a certain number of years
	<i>Annuity</i>	<i>Reversion</i>		<i>Annuity</i>	<i>Reversion</i>
1	\$0.96154	\$0.961538	16	\$11.65229	\$0.533908
2	1.88609	.924556	17	12.16567	.513373
3	2.77509	.888996	18	12.65929	.493628
4	3.62989	.854804	19	13.13394	.474642
5	4.45182	.821927	20	13.59032	.456387
6	5.24214	.790314	21	14.02916	.438834
7	6.00205	.759918	22	14.45111	.421955
8	6.73274	.730690	23	14.85684	.405726
9	7.43533	.702587	24	15.24696	.390121
10	8.11089	.675564	25	15.62203	.375117
11	8.76047	.649581	26	15.98277	.360689
12	9.38507	.624597	27	16.32958	.346816
13	9.98565	.600574	28	16.66306	.333477
14	10.56312	.577475	29	16.98371	.320651
15	11.11839	.555265	30	17.29203	.308319

## GROSS ESTATE—DOWER AND CURTESY.

**117 Art. 16. Dower and curtesy.**—This provision includes dower and curtesy and all interests created by statute in lieu thereof, although the estate or interest so created is different in character. The effect of the provision is to require the inclusion of the full value of the property, without deduction of the value of the interest of the surviving husband or wife. This rule does not apply to the estate of any decedent dying after September 8, 1916, and prior to 6.55 p. m., February 24, 1919 (the effective date of Title IV of the Revenue Act of 1918), unless the property has its situs in a jurisdiction wherein dower, curtesy, or the statutory interest in lieu thereof is subject to the payment of charges against the estate, the expenses of its administration, and is subject to distribution as part of the estate, or unless there has been an election to take property devised or bequeathed in lieu of dower, curtesy, or such statutory interest, and the property so taken has its situs in a jurisdiction by the laws of which it is subject to the payment of such charges and expenses, and to distribution as a part of the estate.

[Bequest in lieu of dower: Court decision, ¶262.]

## GROSS ESTATE—TRANSFERS BY DECEDENT IN HIS LIFETIME.

**118 Art. 17. Nature and time of transfer.**—A transfer made by the decedent at any time, and in any manner, is taxable when made in contemplation of or intended to take effect in possession or enjoyment at or after his death, provided it was not a *bona fide* sale for a fair consideration in money or money's worth. To constitute such a sale it must have been made in good faith, and the price must have been a fair equivalent, and reducible to a money value. The value of property, where title was so transferred by the decedent before September 9, 1916, is to be included in his gross estate if his death occurred after the effective date of the Revenue Act of 1918, but it not to be included if he died prior thereto.

## TRANSFERS IN CONTEMPLATION OF DEATH.

**119 Art. 18. Nature of transfer.**—The words "in contemplation of death" do not mean, on the one hand, a general expectation of death

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## ESTATE TAX REGULATIONS, ETC.

such as all persons entertain, nor, on the other, is the meaning limited to an expectation of immediate death. A transfer, however, is made in contemplation of death wherever the person making it is influenced to do so by such an expectation of death, arising from bodily or mental conditions, as prompts persons to dispose of their property to those whom they deem proper objects of their bounty. Such a transfer is taxable, although the decedent parts absolutely and immediately with his title to and possession and enjoyment of the property. Any transfer made by a decedent within two years prior to his death, without a fair consideration in money or money's worth, is presumed to be taxable if of a material part of his property and in the nature of a final disposition or distribution thereof. The executor must return the value, as of the date of decedent's death, of all property transferred by the decedent at any time in contemplation of death, where the transfer was not a bona fide sale for a fair consideration in money or money's worth, and must disclose in the return all transfers of a material part of decedent's property made at any time without such consideration, but need not include in the gross estate the value of such thereof as he contends were not made in contemplation of death, in which event he may submit with the return evidence of all material facts tending to disclose the decedent's motive at the time, his then anticipation of death, and mental and physical condition.

**120** The presumption of taxability of a transfer made within the two-year period may be rebutted by proof that it was not made under the conditions stated in the statute, and such proof must be filed with the return. Unless proof is submitted which is sufficient to rebut the presumption the transfer will be included in the gross estate in computing the tax.

**121** The fact that a gift was made as an advancement, to be taken into account upon the final distribution of the decedent's estate, is not enough, standing alone, to establish taxability.

[See U. S. Supreme Court decisions relative to above, beginning at ¶425.]

## TRANSFERS INTENDED TO TAKE EFFECT AT OR AFTER DEATH.

**122 Art. 19. General.**—All transfers at any time made by the decedent, other than bona fide sales for a fair consideration in money or money's worth, which were intended to take effect in possession or enjoyment at or after his death, are taxable, and the value of the property so transferred, as of the date of the decedent's death, must be returned as a part of the gross estate.

**123 Art. 20. Reservation of income.**—A transfer, not amounting to a bona fide sale for a fair consideration in money or money's worth, is taxable where the decedent reserved to himself during life the income of the property transferred. In such a case the transfer of the principal takes effect in possession and enjoyment at the death of the decedent, and the value of the entire property should be included in the gross estate. Where the decedent reserved a proportionate part of the income, only a corresponding proportion of the value of the property should be included in the gross estate. If, for example, he reserved one-half of the income, the value of one-half of the property transferred should be included in the gross estate. If he reserved an annuity, so much of the property as is necessary to produce the annuity should be included in the gross estate. A transfer is taxable in accordance with these principles whether the decedent reserved the annuity out of the property conveyed, or payment thereof to him was made by the grantee upon an express or an implied agreement to that effect. Where, however,



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the transfer was made in contemplation of death, the full value of the transferred property, as of the date of the decedent's death, should be included in the gross estate irrespective of the amount of income or of the annuity payable to the decedent.

**124** A gift of the principal intended to take effect either in possession or enjoyment at or after the decedent's death is taxable, although the income during the decedent's life was payable to some one other than himself. Example: The decedent transferred property to his son, the latter agreeing to pay the income to his mother during the decedent's life. The transfer to the son is taxable.

**125 Art. 21. Power of revocation or control.**—Property held in trust under any instrument in which the decedent reserved a power of revocation, or any power which has that effect, constitutes a part of the gross estate. For example, where a decedent placed property in trust for the present benefit of his son, but reserved the power to revoke the trust at any time during his life, the value of the entire property transferred should be included in the gross estate.

**126 Art. 22. Valuation of property transferred.**—The property to be valued is the interest owned and transferred by the decedent; but the value of such property must be ascertained as of the date of the decedent's death. Where the transferee makes additions to the property, or betterments, the enhanced value of the property at that date, due to such additions or betterments, is not to be included.

[See U. S. Supreme Court decisions relative to above, beginning at ¶425.]

## GROSS ESTATE—PROPERTY HELD JOINTLY.

**127 Art. 23. Property held jointly or as tenants by the entirety.**—The statute provides for the inclusion in the gross estate of interests held jointly by the decedent and any other person or persons, and of estates by the entirety. This class of property includes all interests, whether in real or personal property, where the survivor takes the entire property by right of survivorship, and consequently the decedent's interest therein forms no part of his estate for purposes of administration. It does not include interests held as tenants in common, where the interest of each tenant passes free from any right of survivorship.

**128** The following are examples of this class: Real estate held by joint tenants; real estate held by husband and wife (known as an estate by the entirety); money deposited in a bank or trust company in the joint names of the decedent and another and payable to either or the survivor; and, in general, all securities and other personal property, where the title thereto was vested in the decedent and one or more other persons, subject to the right of survivorship.

[Community property—See ¶264.]

**129 Art. 24. Taxable portion.**—The entire value of such property is prima facie a part of the decedent's gross estate, but as it is not the intent of the statute that there should be so included a greater part or proportion thereof than is represented by an outlay of funds, which, in the first instance, were decedent's own, or more than a fractional part equal to that of the other joint owner where neither had parted with any consideration in its acquirement, facts, which in a given case bring it within any one of the exceptions enumerated in the statute, may be submitted by the executor.



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**130** Whether the value of the entire property, on only a part, or none of it, enters into the make-up of the gross estate, depends upon the following considerations: (1) So much of the property (whether the whole, or a part thereof) as originally belonged to the other joint owner, and which at no time in the past had been received or acquired by the latter from the decedent for less than a fair consideration in money or money's worth, forms no part of the decedent's gross estate. (2) Where the facts are otherwise the same as in (1), but the decedent paid to such other joint owner a consideration for the interest by him (the decedent) acquired in the property, then such portion of the value of the property, proportionate to the consideration so paid, constitutes a part of the gross estate. (3) Where the property, or a part thereof, or a part of the consideration wherewith it was acquired, had at any time been acquired by the other joint owner from the decedent as a gift, or for less than a fair consideration in money or money's worth, then such portion of the value of the entire property, proportionate to the consideration, if any, which in the first instance was paid from such other joint owner's own funds, forms no part of the gross estate. (4) Where the property was acquired by the decedent and his or her surviving spouse as tenants in the entirety by gift, will, or inheritance, then but one-half of the value of the property becomes a part of the gross estate. (5) Where acquired by the decedent and the other joint owner as joint tenants by gift, will, or inheritance, and their interests are not otherwise specified, or fixed by law, then one-half only of the value of the property is a part of the gross estate; or, where so acquired by the decedent and two or more persons, and the interests of the several joint tenants are not otherwise determinable, then the decedent and the other joint tenants surviving him shall each be deemed the owner of an equal fractional part, and the value of one only of such fractional parts is to be included in the gross estate.

**131** The following are given as illustrative: (a) The decedent may have furnished the entire purchase price, in which case the value of the entire property should be included in his gross estate; (b) the decedent may have furnished a part only of the purchase price, in which case only the value of a corresponding portion of the property should be so included; (c) the decedent, prior to acquisition of the property by himself and the other joint owner, may have given to the latter a sum of money which later constituted such other joint owner's entire contribution to the purchase price of the property, in which case the entire value of the property should be included; (d) the other joint owner, at a date prior to the acquirement of the property, may have acquired from the decedent, for less than a fair consideration in money or money's worth, property which thereafter became as such, or in a converted form, part of the purchase price of the property. In such a case, the value of the property to be included is to be reduced proportionately to the consideration furnished by the other joint owner in the original transaction; (e) the decedent may have furnished no part of the purchase price, in which case no part of the property should be included; (f) the decedent and spouse may have acquired the property by will as tenants by the entirety, in which case one-half of the value of the property should be included.

### GROSS ESTATE—PROPERTY PASSING UNDER POWER OF APPOINTMENT.

**132** **Art. 25. General rules.**—The value of all property passing under a  
 14 general power of appointment must be included in the gross estate of the person exercising the power (known as the donee, or appointor)

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where the power is exercised by will. It should also be so included when the power is exercised by deed or other instrument executed in contemplation of, or intended to take effect in possession or enjoyment at or after, the death of the donee of the power. The statute, however, does not require inclusion within the gross estate of the value of the appointed property in the case of a bona fide sale thereof by the donee of the power for a fair consideration in money or money's worth.

**133** Only property passing under a *general* power should be included.

A general power is one to appoint to any person or persons in the discretion of the donee of the power. Where the donee is required to appoint to a specified person or class of persons, the property should not be included in his gross estate. Property appointed under a general power should be so included, although the persons to whom the appointment was made would have taken the property had the power not been exercised. A copy of the instrument granting the power should be filed with Form 706 in all cases in order that the Commissioner may determine whether the power is general or special.

**134** Example: The income of property is left to a person for life, with the right to name in his will the person who shall receive the property upon his death. He exercises this power in his will. Upon his death, the value of the property so appointed should be included in his gross estate.

**135** **Art. 26. Powers exercised before and after February 24, 1919.**—The provisions of the Revenue Act of 1918, and those of the present statute, respecting transfers effected through the exercise of a general power of appointment are identical, hence, subject to the exception stated in the preceding article, namely, where the appointment was made for a fair consideration in money or money's worth, the value of all property so transferred by the decedent in the exercise of such a power must be included in the gross estate, if his death occurred subsequent to 6.55 p. m., February 24, 1919 (the effective date of the Revenue Act of 1918). Where, however, the decedent died prior to the effective date of the Revenue Act of 1918, the value of the appointed property is not to be so included.

[See U. S. Supreme Court decision (1916-1917 Acts) relative to the above, ¶403.]

## GROSS ESTATE—INSURANCE.

**136** **Art. 27. Taxable insurance.**—The statute provides for the inclusion

15 in the gross estate of certain forms of insurance taken out by the decedent upon his own life. Two kinds of insurance are taxable:

(a) all insurance receivable by, or for the benefit of, the estate; (b) all other insurance to the extent that it exceeds in the aggregate \$40,000. The term "insurance" refers to life insurance of every description, including death benefits paid by fraternal beneficial societies, operating under the lodge system. Insurance is deemed to be taken out by the decedent in all cases where he pays the premiums, either directly or indirectly, whether or not he makes the application. On the other hand, the insurance is not deemed to be taken out by the decedent, even though the application is made by him, where the premiums are actually paid by the beneficiary, who may be either a person or a corporation. Where the decedent takes out insurance in favor of another person or corporation, as collateral security for a loan or other accommodation, and either directly or indirectly, pays the premiums thereon, the insurance must be considered in determining whether there is an excess



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over \$40,000. The amount of the loan outstanding at decedent's death, with interest accrued thereon to that date, will be deductible in determining the net estate. (See Art. 39.) Where the decedent assigns a policy, and retains no interest therein, and thereafter pays no part of the premiums, the insurance will not be considered in determining whether there is such an excess.

**137 Art. 28. Insurance in favor of the estate.**—The provision requiring the inclusion in the gross estate of all insurance receivable by the executor, without any deduction, applies to policies made payable to the decedent's estate or his executor or administrator, and all insurance which is in fact receivable by, or for the benefit of, the estate. It includes insurance taken out to provide funds to meet the estate tax, and any other taxes or charges which are enforceable against the estate. The manner in which the policy is drawn is immaterial so long as there is an obligation, legally binding upon the beneficiary, to use the proceeds in payment of such taxes or charges.

**138 Art. 29. Insurance receivable by other beneficiaries.**—The estate is entitled to only one exemption of \$40,000 upon insurance receivable by beneficiaries other than the estate. For example, if the decedent left life insurance payable to three such beneficiaries in amounts of \$10,000, \$40,000, and \$50,000 (total, \$100,000), the amount of \$60,000 should be returned for taxation, which is the excess of the sum of the three policies over the exempted amount. The word "beneficiaries," as used in reference to the \$40,000 exemption, means persons entitled to the actual enjoyment of the insurance money.

**139 Art. 30. Effective date of insurance provisions.**—Insurance receivable by the estate must be included in the gross estate of all decedents who died after September 8, 1916. Insurance payable to beneficiaries other than the estate, however, need not be included in the gross estate of decedents who died before the effective date of Title IV of the Revenue Act of 1918, unless the insurance was originally payable to the estate, and the policy was thereafter assigned, or made payable, to a specific beneficiary in contemplation of, or intended to take effect in possession or enjoyment at or after the decedent's death; such assignment or change in beneficiary not being for a fair consideration in money or money's worth.

**140 Art. 31. Valuation of insurance.**—The amount to be returned in the case of any policy is the amount receivable by the estate or other beneficiary. In cases where the proceeds of a policy are made payable to the beneficiary in the form of an annuity for life or for a term of years, the present worth of the annuity at the time of death should be included in the gross estate. For the method of computing the value of such an annuity, see Article 15. Where the insurance contract gives an option to receive a fixed sum of money in lieu of an annuity, this sum, if accepted, represents the value of the insurance for the purpose of the tax. If such sum is not accepted the value of the annuity is to be included in the gross estate. Where there is more than one option, and none of them is convertible, the value of the insurance should be determined in accordance with the option actually exercised.

## DEDUCTIONS—ESTATES OF RESIDENTS.

**141 Art. 32. Deduction of claims, expenses, etc.**—In order to be deductible under the foregoing provision of the statute, the item must fall within one of the several classes of deductions specifically enumer-



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ated therein, and must also, except in the case of deductible losses during the administration of the estate, be one the payment of which out of the estate is authorized by the laws of the jurisdiction under which the estate is being administered. Unless both of these conditions exist, the item is not deductible. Where the item is not one of those described, it is not deductible merely because payment is allowed by the local law. Where the amount which may be expended for the particular purpose is limited by the local law, no deduction in excess of such limitation is permissible. An item may be entered on the return for deduction though the exact amount thereof is not then known, provided it is ascertainable with reasonable certainty, and will be paid. No deduction may be taken upon the basis of a vague or uncertain estimate. When an uncertain or contingent liability was undetermined at the time of audit of the return by the Commissioner, and, as a consequence, deduction was not allowed therefor in such audit, the remedy is by a claim for abatement or refund when the liability and the amount thereof becomes fixed and determined. (See Arts. 93 to 97, inclusive.)

**142 Art. 33. Effect of court decree.**—The decision of a local court as to the amount of a claim or administration expense will ordinarily be accepted where the court passes upon the facts upon which deductibility depends. Where the court does not pass upon such facts its decree will, of course, not be followed. For example, where the question before the court is whether a claim should be allowed, the decree allowing it will ordinarily be accepted as establishing that the claim is valid and the amount of it. Where, however, a legacy is left to an executor in lieu of commissions, the allowance of the legacy does not establish that the executor's claim for commissions is equal to the amount bequeathed, and that this amount is consequently deductible. (See Art. 36.) Nor will the decree necessarily be accepted even where it purports to decide the facts upon which deductibility depends. It must appear that the court actually passed upon the merits of the case. This will be presumed in all cases where there is an active and genuine contest. Where the result reached appears to be unreasonable, this is some evidence that there was not such a contest, but it may be rebutted by proof to the contrary. Where the decree was rendered by consent, it will be accepted, provided the consent was a *bona fide* recognition of the validity of the claim—not a mere cloak for a gift—and was accepted by the court as satisfactory evidence upon the merits. It will be presumed that the consent was of this character, and was so accepted, where it is made by all parties having an interest adverse to the claim, when all aspects of the matter, including its effect upon taxation, are considered. The decree will not be accepted where it appears to be at variance with the law of the state; as, for example, if an allowance is made to an executor in excess of the rate prescribed by statute.

**143 Art. 34. Funeral expenses.**—An executor may deduct such amounts for funeral expenses as are actually expended by him, provided expenditures of this nature are a liability of the estate under the laws of the local jurisdiction. A reasonable expenditure by the executor for a tombstone, monument, mausoleum, or for a burial lot, either for the decedent or his family, may be deducted under this heading, provided such an expenditure is made a charge upon the estate by the local law. Included in funeral expenses is the cost of transportation of the person bringing the body to the place of burial.

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**144 Art. 35. Administration expenses.**—The amounts deductible from the gross estate as “administration expenses” are such expenses as are actually and necessarily incurred in the administration of the estate; that is, in the collection of assets, payment of debts, and distribution among the persons entitled. The expenses contemplated in the law are such only as attend the settlement of an estate by the legal representative preliminary to the transfer of the property to individual beneficiaries or to a trustee, whether such trustee is the executor or some other person. Expenditures not essential to the proper settlement of the estate, but incurred for the individual benefit of the heirs, legatees, or devisees, may not be taken as deductions. Administration expenses include (1) executor’s commissions; (2) attorney’s fees; (3) miscellaneous expenses. Each of these classes is considered separately. (See Arts. 36 to 38, inclusive.)

**145 Art. 36. Executor’s commissions.**—The amount deductible as executor’s or administrator’s commissions is such amount as has actually been paid or which at the time the return is filed it is reasonably expected will be paid, but no deduction will be allowed if no commissions are to be collected. Where the amount of the commissions has not been fixed by decree of the proper court, the deduction will be allowed on the final audit of the return provided: (1) That the Commissioner is reasonably satisfied that the commissions claimed will be paid; (2) that the amount entered as a deduction is within the amount allowable by the laws of the jurisdiction wherein the estate is being administered; and (3) that it is in accordance with the usually accepted practice in said jurisdiction in estates of similar size and character. Where the commissions claimed have not been awarded by the proper court the Commissioner on final audit may disallow the deduction in part or in whole, as the circumstances in his judgment justify, subject to such future adjustment as the facts may later require. If the deduction is allowed in advance of payment and payment is thereafter waived, it shall be the duty of the executor to notify the Commissioner.

**146** Executors should note that the amounts received in payment of the commissions constitute taxable income and that amounts allowed on final audit are cross-referenced for income-tax purposes.

**147** A bequest to an executor in lieu of commissions is deductible as an administration expense in the amount that it does not exceed commissions allowable under local law and practice.

**148** Amounts paid as trustees’ commissions do not constitute expenses of administration and are not deductible, whether received by the executor acting in the capacity of a trustee or by a separate trustee as such.

**149 Art. 37. Attorney’s fees.**—The amount deductible as attorney’s fee is the amount actually paid as such or which at the time the return is filed it is reasonably expected will be paid. If on the final audit of a return, the fees claimed have not been awarded by the proper court and paid, the deduction will be allowed, provided that the Commissioner is reasonably satisfied that the amount claimed will be paid and that it does not exceed a reasonable remuneration for the services rendered, taking into full account the size and character of the estate and local law and practice.

**150** Where the attorney’s fees have not been paid at the time of the final audit of the return, the Commissioner may disallow the deduction in part or in whole, as the circumstances may warrant, subject to such future adjustment as the facts may require.



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**151** Attorney's fees incident to litigation instituted by the beneficiaries as to their respective interests do not constitute a proper deduction, inasmuch as expenses of this character are properly charges against the beneficiaries personally and are not administration expenses as contemplated by the statute.

**152** **Art. 38. Miscellaneous administration expenses.**—This item includes expenses incident to court proceedings, or the administration of the estate, such as court costs, surrogates' fees, accountants' fees, appraisers' fees, clerk hire, etc. Expenses necessarily incurred in distributing the estate are deductible. This includes the cost of storing or maintaining property of the estate, where it is impossible to effect immediate distribution to the beneficiaries. Expenses for preserving and caring for the property may be deducted, but do not include additions or improvements; nor will such expenses be allowed for a longer period than the executor is required to retain the property. A brokerage fee for selling property of the estate is deductible where the sale is necessary in order to pay the decedent's debts, or the expenses of administration, or to effect distribution. Other expenses attending the sale are deductible, such as the fees of an auctioneer, where it is reasonably necessary to employ one.

**153** **Art. 39. Claims against the estate.**—The amounts that may be deducted under this heading are such only as represent personal obligations of the decedent existing at the time of his death, whether then matured or not. Only such claims as are enforceable against the estate may be deducted.

**154** **Art. 40. Taxes.**—Taxes upon real property should be accrued to the date of death in order to reflect in the gross estate the value of the property upon which they were imposed. This is done by ascertaining the time between the first day of the taxable period wherein the death occurs and the date of death, and computing the proportion of the entire tax upon the basis which this period bears to the entire taxable period. Such proportion of the tax had accrued upon the date of death, and is deductible.

**155** Taxes upon personal property are either wholly deductible, or are not deductible at all, depending upon whether the tax did, or did not, become the personal obligation of the taxpayer in his lifetime. If the tax became his personal obligation during his life, the whole amount is deductible as a claim against his estate. If it did not become such personal obligation in his lifetime, no part of it is deductible. The question when the tax became the personal obligation of the taxpayer depends upon the law of the jurisdiction imposing the tax. Prima facie, the date when the tax became the personal obligation of the taxpayer is the date when the assessment was laid.

**156** Federal taxes upon income received or accrued during the decedent's lifetime constitute a personal obligation of the decedent, and are deductible. Taxes upon income received after the decedent's death are not deductible. No estate, succession, legacy, or inheritance tax is deductible [see U. S. Supreme Court decision at ¶397].

**157** **Art. 41. Unpaid mortgages.**—The full amount of unpaid mortgages on property included in the gross estate should be deducted under this heading, including interest which had accrued at the time of death, whether payable at that time or not. The full value of the real estate, without



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any deduction for mortgages, must be returned as part of the gross estate. Real property situated outside the United States is not a part of the gross estate of a resident decedent, nor may deduction be taken of any mortgage upon, or any indebtedness in respect to, such property when owned by a resident decedent.

**158 Art. 42. Losses from casualty or theft.**—There may be deducted under this heading losses incurred during the settlement of the estate arising from fires, storms, shipwreck, or other casualty, or from theft, when such losses are not compensated for by insurance or otherwise. If the loss is partly compensated, the excess of the loss over such compensation may be deducted. Losses not of the nature described are not deductible. Losses sustained by reason of depreciation or otherwise in the value of assets of the estate subsequent to the decedent's death, when not arising from any of the causes named, are not deductible. In order to be deductible a loss must occur during the settlement of the estate. Where property has been delivered to the beneficiary, settlement has been effected, and no deduction may be had for loss of the property.

**159 Art. 43. Support of dependents.**—The support during the settlement of the estate of dependents of the decedent should be deducted, but pursuant to the following rules:

(1) In order to be deductible, the allowance must be authorized by the laws of the jurisdiction in which the estate is being administered, and not in excess of what is reasonably required.

(2) The allowance for which deduction may be made is limited to support during the settlement of the estate. Any allowance for a more extended period is not deductible.

(3) There must be an actual disbursement from the estate to the dependents, but after payment has been made the right of deduction is not affected by the fact that the dependents do not expend the entire amount for their support during the settlement of the estate.

### DEDUCTIONS—PROPERTY PREVIOUSLY TAXED.

**160 Art. 44. Deduction of the value of transfers taxed within five**  
19 **years.**—Where there is included in the decedent's gross estate property received by him by gift, will, or inheritance from any person who died within five years prior to his death, or property acquired in exchange for property so received, the statute authorizes a deduction in behalf thereof, subject to the following conditions and limitations, namely:

(1) The two deaths must have occurred within five years of each other.

(2) The property must be identified either as the same which the decedent so received, or subsequently acquired in exchange therefor.

(3) The property must have formed a part of the gross estate, situated in the United States, of such prior decedent.

(4) An estate tax must have actually been paid by or on behalf of the estate of such prior decedent (the mere filing of a return for such estate not being sufficient).

(5) The property, or that acquired in exchange therefor, in so far as it constitutes a part of the decedent's gross estate, is, for the purpose of inclusion therein, to be valued as of the date of the decedent's death.

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(6) The deduction, however, is limited to the value which the Commissioner placed on the property in determining the value of the gross estate of the prior decedent.

(7) The deduction is also limited to the extent that the value of the property, or that acquired in exchange therefor, is included in the decedent's gross estate. (See example following the next paragraph.)

(8) The deduction is further limited to the extent that the value of the property, or of that so acquired in exchange, is not deducted under paragraphs (1) or (3) of subdivision (a) of section 403.

**161** Example: The decedent's father died January 1, 1917. Included in his gross estate was a tract of land comprising 200 acres upon which the Commissioner placed a value for estate tax purposes of \$20,000. The tax on the father's estate was paid. The son, having inherited the tract from his father, sold 100 acres thereof on January 1, 1920, for \$20,000, and commingled the proceeds with his other funds. On the son's death, which occurred January 1, 1921, the remaining one-half of the land was returned as a part of his gross estate at \$20,000, which was the fair market value thereof as of the date of his death. Since only one-half of the tract was included in the son's gross estate, the deduction is limited to one-half of the value placed by the Commissioner upon the whole tract when determining the value of the father's gross estate, or \$10,000.

**162** Under the provisions of the Revenue Act of 1918 the deduction was available only where the prior decedent died after October 3, 1917, the date of the passage of the Revenue Act of 1917, and the decedent's death occurred subsequent to the effective date of the Revenue Act of 1918. But under the provisions of the Revenue Act of 1921 the right to such deduction is made available to the estates of all decedents dying since September 8, 1916. Where, under the provisions of the Revenue Act of 1918, or any prior act of Congress imposing an estate tax, the deduction was not available, the right thereto is to be determined in accordance with the provisions of paragraph (2) of subdivision (a) of section 403 of the Revenue Act of 1921, but where available under the Revenue Act of 1918, it is governed by paragraph (2) of subdivision (a) of section 403 of that act. Where the tax has been paid without taking the deduction, a claim for refund may be made, as provided by Article 96.

**163** The burden of proving that the estate is entitled to the deduction rests upon the executor.

**164** **Art. 45. Property originally received.**—If the property originally received from the prior decedent is included in the decedent's gross estate, the executor must describe it fully, and prove its identity.

**165** **Art. 46. Property acquired in exchange.**—The deduction for substituted property is limited to property acquired in exchange for the identical property received from the prior decedent. Where there is a subsequent exchange, the right to deduction is lost.

**166** In the case of an exchange the executor must describe and identify fully both the property originally received from the prior decedent and the property acquired in exchange therefor. He must also state the date of the transaction by which the exchange was effected and the name and address of the transferee. If the exchange was made by written instrument of public record, a precise reference must be made to the record containing a transcript of the instrument, and, if by instrument not of record, a copy of



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the instrument itself must be supplied. If there was no written instrument, an affidavit as to the facts of the exchange by one or more persons having personal knowledge of the matter must be furnished.

**DEDUCTIONS—TRANSFERS FOR PUBLIC, CHARITABLE, ETC., USES.**

**167** **Art. 47. Transfers for public, charitable, religious, etc., uses.**—In the estates of decedents dying after December 31, 1917, deduction may be taken of the value of all property transferred by will, or by the decedent in his lifetime in contemplation of or intended to take effect in possession or enjoyment at or after his death (not including, however, the value of property sold for a fair consideration in money or money's worth), where, in either case, the property is, or has been, transferred (1) to or for the use of the United States, any State, Territory, any political subdivision thereof, or the District of Columbia, for exclusively public purposes; or (2) to or for the use of any corporation or association organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes (including the encouragement of art and the prevention of cruelty to children or animals), where no part of the net earnings of the corporation or association inures to the benefit of any private stockholder or individual; or (3) to a trustee or trustees exclusively for one or more of the purposes enumerated in (2).

**168** Where a trust is created for both a charitable and a private purpose, deduction may be taken of the value of the beneficial interest in favor of the former only in so far as such interest is presently ascertainable, and hence severable from the interest in favor of the private use. Thus, when money or property is placed in trust to pay the income to an individual during his life, and then to pay or deliver the principal to a charitable corporation, or to apply it to a charitable purpose, the present value of the principal is deductible. For the manner of determining such value, see Article 15.

**169** The deduction is not limited, in the estates of resident decedents, to transfers to domestic corporations or associations, or to trustees for use within the United States.

[See Court decision bearing on above, at ¶298.]

**170** **Art. 48. Religious, charitable, scientific, and educational corporations.**—A corporation or association to which such a transfer was made must meet three tests: (1) it must be organized and operated for one or more of the specified purposes; (2) it must be organized and operated *exclusively* for such purpose or purposes; and (3) no part of its net earnings shall inure to the benefit of private stockholders or individuals.

**171** The estate is not deprived of the right to deduct the value of property so transferred by reason of the fact that private individuals are the recipients of the benefits which the corporation or association dispenses. Such right is, however, lost wherever any part of the net earnings of the corporation or association inures to the benefit of a private stockholder or individual. Thus, if the shareholders or members of the corporation or association are entitled, upon a dissolution thereof, to receive the proceeds of its property, including accumulated net earnings, no right of deduction exists, even though the by-laws provide that the shareholders or members shall not receive dividends or other return upon their shares or interests.

**172** **Art. 49. Proof required.**—In order to prove the right of the estate to this deduction the executor must submit:



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(1) Duplicate copies of the will of the decedent or the instrument, if any, in the case of a transfer of property in contemplation of or intended to take effect in possession or enjoyment at or after death, as required by Article 69. Where copies of the will are submitted it will be sufficient if one of these copies is certified, but in such cases the collector should forward the certified copy to the commissioner.

(2) An affidavit by the executor stating whether any action has been instituted to contest the will and whether, according to his information and belief, any such action is contemplated.

(3) Such other documents or evidence as may be requested by the commissioner on review. A return will not be considered as complete within the meaning of section 407 of the act until all such evidence has been submitted.

**173 Art. 50. Conditional bequests.**—Where the transfer is dependent upon the performance of some act or the happening of some event in order to become effective, it is necessary that the performance of the act or the occurrence of the event shall have taken place before the deduction can be allowed.

**174** Where the legatee, devisee, donee, or trustee is empowered to divert the property or fund, in whole or in part, to a use or purpose which would have rendered it, to the extent that it is subject to such power, not deductible had it been directly so bequeathed, devised, or given by the decedent, deduction will be limited to that portion, if any, of the property or fund which is exempt from an exercise of such power.

**175 Art. 51. Effective date.**—The deduction may be claimed by the estates of all decedents dying after December 31, 1917. Where the tax has been paid without taking the deduction, a claim for refund may be made, as provided by Article 96.

## SPECIFIC EXEMPTION.

**176 Art. 52. Specific exemption.**—There may be deducted from the gross estate of all resident decedents a specific exemption of \$50,000. No such exemption is allowed in the estates of nonresident decedents. If more than one return is made for purposes of the tax, the exemption may be taken but once.

## ESTATES OF NONRESIDENTS.

**177 Art. 53. Situs of property of nonresident decedents.**—Bonds actually within the United States, moneys due on open accounts by domestic debtors, and stock of a corporation or association created or organized in the United States, constitute property having its situs in the United States. On the other hand, insurance upon the life of a nonresident, and moneys deposited with any person or corporation carrying on the banking business in the United States by or for a nonresident not engaged in business in the United States at the time of his death, are not to be regarded as property situated therein. [U. S. bonds, etc., see ¶308.]

**178** Property of which the decedent has made a transfer, or with respect to which he has created a trust, in contemplation of, or intended to take effect in possession or enjoyment at or after, death, is deemed to be situated in the United States if so situated either at the time of the transfer or the creation of the trust, or at the time of the decedent's death.

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## DEDUCTIONS—ESTATES OF NONRESIDENTS.

**179** **Art. 54. Net estate.**—The gross estate of a resident and of a non-  
**22** resident are made up in the same way. In ascertaining the net estate, however, the transfer of which is subject to tax, there is a radical difference between the two cases. The net estate in the case of a resident is determined by making specified deductions from the entire gross estate, whereas the net estate in the case of a nonresident is determined by making the deductions from the value of so much of the gross estate as is situated in the United States. Thus, in substance, the statute imposes the tax only upon the transfer of so much of the estate of a nonresident as, under the terms of the statute, had its situs in the United States. On the other hand, the estates of nonresidents are not entitled to the specific exemption of \$50,000. (See Art. 58.)

**180** **Art. 55. Deduction of claims, expenses, etc.**—In estates of non-  
**23** residents, deduction from gross estate may be taken, subject to the  
**26** limitations herein subsequently to be referred to, of disbursements for funeral expenses, administration expenses, claims against the estate, unpaid mortgages, losses incurred during the settlement of the estate arising from fires, storms, shipwreck, or other casualty, or from theft, when such losses are not compensated for by insurance or otherwise, amounts reasonably required and actually expended for the support during settlement of the estate of those dependent upon the decedent, as are allowed by the laws of the jurisdiction under which the estate is being administered. Treatment of the several deductions enumerated above will be found in Articles 32 to 43, inclusive. No deduction may be taken of any income taxes upon income received after the death of the decedent, or of any estate, succession, legacy, or inheritance taxes. It is immaterial whether the amounts to be deducted were incurred or expended within or without the United States, but certain limitations are imposed which do not apply to estates of resident decedents, namely: (1) Only that proportion of the aggregate thereof is deductible which the value of that part of the gross estate, which at the time of decedent's death, was situated in the United States, bears to the value of the entire gross estate, wherever situated; and in no event may a sum be deducted in excess of 10 per centum of the value of that part of the gross estate which at the time of death was situated in the United States. (See Art. 58.) Such 10 per centum limitation does not apply to the deduction subsequently considered in Articles 56 and 57. (2) No deduction whatever may be taken unless the executor includes in the return the value at the date of the nonresident's death of that part of the gross estate not situated in the United States.

**181** In order that the Commissioner may properly pass upon the items claimed as deductions, the executor should submit a certified copy of the schedule of liabilities, claims against the estate and expenses of administration filed under the foreign estate, succession, or death-duty act; or, if no such schedule was filed, a certified copy of the schedule of such liabilities, claims and expenses filed with the foreign court in which administration was had; or, if items of deduction allowable under section 403 (b) (1) were not included in either such schedule, or, if no such schedules were filed, then the affidavit of the foreign executor setting forth the facts relied upon as entitling the estate to the benefit of the particular deduction or deductions.



**182 Art. 56. Deduction of value of transfers taxed within five years.—**  
 24 The right to deduct the value of property received by a nonresident  
 26 decedent from any person dying within five years prior to his death,  
 or of the value of property acquired in exchange for property so re-  
 ceived, is governed by the same rules as those which apply to estates of resident  
 decedents, subject to the two following exceptions: (1) That such right is  
 limited to the extent that the value of the property, or of that acquired in  
 exchange therefor, is not deducted under paragraphs (1) or (3) of subdivision  
 (b) of Section 403; (2) That such right is not available to any extent unless  
 the executor includes in the return the value at the time of the decedent's  
 death of that part of the gross estate not situated in the United States. (See  
 Arts. 44 to 46, inclusive.)

**183 Art. 57. Deduction of value of transfers for public, charitable, re-**  
 25 **ligious, etc., uses.—**The right to deduct the value of property trans-  
 26 ferred by nonresidents for public, religious, charitable, scientific,  
 literary, or educational purposes is governed by the same rules as  
 those applying to estates of resident decedents (Arts. 47 to 51, inclusive),  
 subject, however, to the two following exceptions, namely: (1) That the right  
 is limited to transfers to corporations and associations created or organized  
 in the United States, or to trustees for use within the United States, and, (2)  
 is then available only where the executor includes in the return the value at  
 the time of the nonresident decedent's death of that part of the gross estate  
 not situated in the United States.

**184 Art. 58. Determination of net estate.—**The following example will  
 show the manner of determining the net estate of a nonresident  
 decedent. The gross estate, wherever situated, amounts to \$1,000,000, of  
 which \$200,000 represents the value of the property having its situs within  
 the United States (the term "United States" including not only the several  
 States, but also the Territories of Alaska and Hawaii, and the District of  
 Columbia). The funeral expenses, administration expenses, and claims  
 against the estate aggregate \$75,000, and there are charitable bequests, for  
 use within the United States, amounting to \$25,000. Hence the property  
 situated within the United States constitutes 20 per cent of the entire gross  
 estate wherever situated, and a like percentage of the \$75,000 is \$15,000. As  
 the last named amount does not exceed 10 per cent of the value of the property  
 situated in the United States, the whole thereof is deductible. The fol-  
 lowing result is accordingly obtained:

Gross estate within the United States.....	\$200,000
20 per cent of \$75,000.....	\$15,000
Charitable bequests for use within the United States.....	25,000
	<u>40,000</u>

Net estate..... \$160,000

**185** For the manner of computing the tax on the net estate, see Article 8.

In the example given, had the funeral expenses, administration ex-  
 penses and claims against the estate aggregated \$150,000, 20 per cent thereof,  
 or \$30,000, would not have been deductible for the reason that it would  
 have exceeded 10 per cent of the value of the property situated in the United  
 States; such 10 per cent being the maximum permitted by the statute.  
 The deduction would accordingly have been limited to 10 per cent of \$200,000,  
 plus the charitable bequests, or a total of \$45,000, and the resultant net estate  
 would have been \$155,000, instead of the amount given in the example.

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**186 Art. 59. Payment of tax.**—The provisions relating to rates and payment of the tax are the same in estates of nonresidents and of residents. The statute provides that the executor shall pay the tax. If no executor or administrator has been appointed, every person in either the actual or constructive possession of any property of the decedent is constituted by the statute an executor for the purpose of tax payment, and is liable for the tax to the extent of the property so in his possession. All checks, drafts, or money orders should be made payable to the order of Collector of Internal Revenue. (See Arts. 79 to 83, inclusive.)

## PRELIMINARY NOTICE—ESTATES OF RESIDENTS.

**187 Art. 60. When notice required.**—A preliminary notice is required to  
31 be filed in the case of every resident decedent whose gross estate exceeded \$50,000 in value at date of death. This notice must be filed in duplicate with the collector in whose district the decedent had his domicile at the time of death. Where there is doubt as to whether the gross estate exceeds \$50,000, the notice should be filed, as a matter of precaution, in order to avoid penalties.

**188 Art. 61. Notice by executor or administrator.**—The duly qualified executor or administrator is required to file such preliminary notice on Form 704, copies of which may be obtained from the collector, within two months after qualifying as such, if notice has not already been filed. The primary purpose of the notice is to advise the Government of the existence of taxable estates, and filing should not be delayed beyond the two-months period because of uncertainty as to the exact value of the assets. Since the filing of the notice within the prescribed period is mandatory, the estimate of the gross estate called for by the notice is merely the best approximation of value which can be made within the time allowed. The instructions upon the back of the form should be read carefully before executing the notice. The signature of one executor or administrator upon Form 704 is sufficient. For penalties for delinquency in filing notice, or for filing a false or fraudulent notice, see Articles 88 to 90, inclusive.

**189 Art. 62. Notice by others than duly qualified executor or administrator.**—The term "executor" embraces any person in actual or constructive possession of any property of the decedent at the time of the latter's death, where there is no duly qualified executor or administrator. The notice on Form 704 must be filed by such persons in every case where an executor or administrator has not duly qualified as such within two months next following the decedent's death. Where, however, an executor or administrator qualifies within such period, the duty of filing the notice devolves upon him, and all other persons are relieved therefrom. [See ¶311.]

**190 Art. 63. Exemption claimed on account of military service; notice required.**—The executors of estates claiming the right to exemption from the tax under the provisions of Section 401 (see Art. 9), are required to file the two-months notice with the proper collector in the same manner as the executors of taxable estates. The executor should, in addition, write across the face of the form the words "Exemption claimed on account of military service."

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## NOTICE—ESTATES OF NONRESIDENTS.

**191 Art. 64. Estates of nonresidents; preliminary notice.**—In estates of  
31 nonresidents, notice on Form 705 should be filed with the Commissioner of Internal Revenue, Washington, D. C., by every duly qualified executor or administrator. The notice is necessary if any part of the decedent's gross estate was situated in the United States at the time of death, regardless of the value of that part or of the entire gross estate. If no executor or administrator has been appointed, notice must be filed within two months after the date of death by every person in either the actual or constructive possession of any property of the decedent within the United States at the time of his death. If such person has no knowledge of the decedent's death within two months following its occurrence, he should file the notice immediately upon obtaining such knowledge. If there is a delay of more than two months after the death in the appointment of an executor or administrator, persons so in possession should file notice. The term "person in actual or constructive possession of any property of the decedent" (Section 400) includes, among others, the decedent's agents and representatives; safe-deposit companies, warehouse companies, and similar custodians of property in this country of a nonresident decedent; brokers holding as collateral securities belonging to the decedent or investment funds owned by the decedent, and debtors of the decedent in this country, but does not include any person, corporation, or association carrying on the banking business with whom or with which money was deposited by or for the decedent, unless, however, the decedent was engaged in business in the United States at the time of his death.

**192 Art. 65. Transfer agents' notice.**—A notice on Form 714 is required to be filed whenever a corporation, its transfer agent, registrar, or paying agent, is called upon to make a transfer of stock or bonds, or to pay dividends or interest, to any successor in interest of a nonresident stockholder or bondholder who died after September 8, 1916, unless the transfer is made upon the order of an executor or administrator appointed in the United States. The notice is required for dividends declared, and for interest which had accrued on bonds, prior to the death of the decedent, although payable thereafter. Notice should be filed with the Commissioner of Internal Revenue at Washington, D. C., within two months following the date of death, or immediately upon receipt of the request for transfer or payment. A transfer agent should be vigilant to report all cases in which the fact of the death of a nonresident appears. Where the securities are received without the personal assignment of the decedent, but with the transfer order of the foreign executor, it is clear that the case should be reported. Where the securities bear the personal assignment of the decedent, the transfer should be reported if made upon the order of a foreign executor, or if information is received in any other manner that the record owner has died a nonresident of the United States.

**193** In order to prevent loss of the tax upon nonresident estates, it is essential that transfer agents exercise great care in reporting all transfers of the kind described. Their records will be examined from time to time by internal-revenue officers to determine whether this regulation is being strictly complied with. Failure to file notice in the manner prescribed will render the transfer agent liable to a fine.



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**194 Art. 66. Transfer of stocks and bonds of nonresident decedents; how made.**—Wherever a transfer agent is required to file the notice as provided in Article 65, he shall not make transfer of any stocks or bonds standing in the name of a nonresident decedent until there has been delivered to such collector of internal revenue as may be designated by the Commissioner the bond of the party to whom the stocks or bonds are to be transferred with corporate surety in an amount to be fixed by the Commissioner, not exceeding in amount the value of the stocks or bonds to be transferred, conditioned for the payment of the tax upon the transfer of the decedent's net estate. Upon receipt of such notice the Commissioner will at once, upon request, fix the amount for which the bond is to be given. In lieu of such bond a deposit, either of money or of bonds of the United States, of the amount so fixed may be made with such collector of internal revenue as the Commissioner may designate.

**195** Where bonds of the United States or moneys are deposited in lieu of the delivery of such corporate bond, return will be made thereof to the depositor after payment in full of the tax on the transfer of the decedent's net estate. If, however, the tax be not paid in full on or before the due date thereof, or within such period as payment may have been extended by the Commissioner, the collateral will be subjected to payment of the tax, or the then unpaid balance thereof, and the excess of the deposit, or of the proceeds thereof remaining, if any, will be returned to the depositor. In lieu of the provisions and restrictions hereinbefore set forth, transfer agents are authorized to make transfer of stocks and bonds standing in the name of a nonresident decedent to the duly qualified ancillary executor or administrator within the United States, provided that such transfer agent at the time of making such transfer gives notice thereof in writing to the Commissioner of Internal Revenue.

## THE RETURN—ESTATES OF RESIDENTS.

**196 Art. 67. When return required.—Date of filing.**—A return on Form 31 706 is required in the case of every resident decedent whose gross 32 estate, as defined in the statute, exceeded \$50,000 in value. This return must be filed with the collector for the district in which the decedent was domiciled at the time of his death. It must be filed in duplicate within one year after the date of death. When the due date for filing the return, Form 706, falls on a Sunday or on a legal holiday, the due date for filing will be the day following such Sunday or legal holiday.

**197** If it is impossible for the executor to file a reasonably complete return within one year from the date of death, the Commissioner may, upon application from the executor showing good and sufficient cause, grant extensions of time not to exceed a total of 180 days from the due date, and no single extension to exceed 60 days. At the expiration of the last extension period granted, a return as complete as possible must be filed, and the executor may thereafter file an amended return when the condition of the estate permits. An extension of time for filing the return does not operate to extend the time for the payment of the tax, which is due one year after the decedent's death unless an extension of time in which to make payment has been obtained as provided in article 82.

**198 Art. 68. Persons liable for return.**—The statute provides that the duly qualified executor or administrator shall file the return. If there



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is more than one executor or administrator, the return must be made jointly by all. Where no executor or administrator has been appointed, every person in actual or constructive possession of any property of the decedent is constituted by the statute an executor for the purposes of the tax, and is required to make and file a return as provided by Section 404. Where, in any case, the executor is unable to make a complete return as to any part of the gross estate, he is required to give all the information he has as to such property, including a full description, and the name of every person holding a legal or beneficial interest in the property. Where the executor is unable to make a return as to any property, the statute requires every person holding a legal or beneficial interest therein, upon notice from the collector, to make return as to such part of the gross estate. For penalties for delinquency in filing return, or for filing a false or fraudulent return, see Articles 88 to 90, inclusive.

**199 Art. 69. Preparation of return.**—The return must be made on Form 706, copies of which will be supplied by the collector. It must contain an itemized inventory, by schedule, of the property constituting the gross estate, and of the deductions. The instructions printed on the form should be carefully followed. All documents and vouchers used in preparing the return should be retained by the executor, so as to be available for inspection whenever required. Duplicate certified copies of the will, if any, must be submitted with the return, together with duplicate copies of the other documents required by the instructions printed on the form, or any documents which the executor may desire to submit with the return in explanation thereof.

**200 Art. 70. Supplemental data.**—The statute provides that the executor, in addition to filing notice and return, shall furnish such supplemental data as may be necessary to establish the correct tax. It is therefore the duty of the executor to furnish upon request copies of any documents in his possession relating to the estate, or on file in any court having jurisdiction over the estate, appraisal lists of any items included in the gross estate, copies of balance sheets or other financial statements relating to the value of stock, and any other information obtainable by him that may be found necessary in the determination of the tax. Failure to comply with such a request will render the executor liable to a fine not to exceed \$500, and proceedings may be instituted in the proper United States court to secure compliance therewith. (See Sections 410 and 404.)

**201 Art. 71. Procedure where no return has been made.**—Section 405 of the statute provides that if no return is filed for the estate of a decedent, or if a return contains a false or incorrect statement of a material fact, the collector or deputy collector shall make a return. The Commissioner may amend this return from such knowledge or information as he can obtain, through testimony or otherwise. A return so made by the Commissioner, or made by the collector or deputy collector, is a sufficient basis for assessing the tax. Where a tax is found to be due upon such a return, both the estate and the executor will be liable for penalties as well as for the tax.

**202 Art. 72. Investigation of returns.**—An investigation of every return for estate tax will be conducted to verify its accuracy. The investi-

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gation will be made by special officers of the Bureau. The fact that an investigation is made does not reflect upon the competence or good faith of the executor, since investigations are required in all cases. The executor should co-operate with the examining officer in order that the tax liability may be correctly determined and the case closed. During the course of the investigation the examining officer will inspect the books and records of the estate, interview the executor and other persons having knowledge of the decedent's affairs, verify the value of the assets and the deductions, and take such other steps as may be necessary in order that the correct amount of tax may be determined.

**203** Upon completion of the investigation the executor will be apprised by the examining officer of his findings, and will be given an opportunity to discuss the case and present such data as he may desire the Commissioner to consider in connection with the examining officer's report. Upon the completion of a review and audit by the Commissioner, the executor will be informed by letter of the result thereof. If the letter contains notification of an amount of unpaid tax, such unpaid amount should be remitted promptly to the collector, and if not paid within the time specified by the applicable provisions of section 406 or section 407, interest will be added as required thereby. (See Art. 83.)

**204** It is the purpose of the Commissioner to make these investigations as soon as practicable after the filing of the return. Where the executor files a *complete* return, and makes written application to the Commissioner for a determination of the tax and discharge from personal liability therefor, the Commissioner will, within one year after receipt of such application, notify the executor of the amount of the tax, and, upon payment thereof, the executor will be discharged from personal liability for any additional estate tax thereafter found to be due. (See Sec. 407.) This provision applies also to cases arising under the Revenue Act of 1918. Attention is here directed to Section 250 (d) of the statute which embodies a provision, "That in the case of *income* received during the lifetime of a decedent, all taxes due thereon shall be determined and assessed by the Commissioner within one year after written request therefor by the executor, administrator, or other fiduciary representing the estate of such decedent: \* \* \*"

## THE RETURN—ESTATES OF NONRESIDENTS.

**205** **Art. 73. Return of estates of nonresidents.**—A return on Form 706 must be filed in duplicate with the Commissioner of Internal Revenue, Washington, D. C., or with such collector of internal revenue as the Commissioner may designate, within one year after the date of death of ever nonresident decedent, if any part of the gross estate of such decedent was situated in the United States at the time of his death. It is the duty of the duly qualified executor or administrator to file a return for the whole of that part of the gross estate situated in the United States, whatever its value. If the duly qualified executor or administrator is unable to make a complete return as to any part of the gross estate, he is required to give all the information available to him as to such part, including a description thereof and the name of every person holding a legal or beneficial interest therein. If deductions are claimed, see Articles 55, 56 and 57. If no executor or administrator has been appointed, all persons in actual or constructive possession of any property of the decedent situated in the United States are required to file a return for such portion of the gross estate as had its situs therein. (See Art. 53.)

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**206 Art. 74. Supplemental data.**—Pursuant to the provisions of Section 404, with respect to furnishing supplemental data, the duly qualified executor or administrator of a nonresident decedent is required to file with the return:

(1) Certified copy of will, or, if the decedent left several wills, to govern in different jurisdictions, certified copy of each will.

(2) Certified copy of inventory of property filed under a foreign estate, succession or death-duty act; or, if no such inventory was filed, a certified copy of inventory filed with the foreign court of probate jurisdiction.

**207** The specified information is required whether or not the executor wishes to claim the deductions authorized in section 403(b).

**PRIVILEGED CHARACTER OF RETURNS.**

**208 Art. 75. Returns confidential.**—All estate tax returns and notices are treated as privileged communications and may not be exhibited to any person other than the executor or his duly authorized agent, except as stated in Article 76. This requirement of secrecy will be rigidly enforced, and extends to information of a private nature submitted or obtained in connection with a return or notice. The requirement does not operate to prevent internal revenue officers from disclosing the returned value of any item or the amount of any specific deduction, where such disclosure is necessary in order to arrive at a correct determination of the tax. This right of disclosure, however, does not extend to such information as the amount of the estate, the amount of tax, or other general data. Nor are the records in possession of the Bureau, whether on file with the Commissioner or the collector, open to inspection, except as provided in Article 76.

**209 Art. 76. Disclosure to persons having material interest.**—Where any person other than the executor has a material interest in ascertaining any fact disclosed by the return, or in obtaining information as to the payment of the tax, he shall make a written application to the Commissioner of Internal Revenue for such information, setting forth the nature of his interest and the purpose of the application. The Commissioner will review the application, and, if it is approved, the collector will be directed to exhibit the return to the applicant, or give him such information as is specified, or the Commissioner may permit an inspection of the return on file in the Bureau, or furnish such information as he deems advisable. Under no circumstances shall the collector give information to persons other than the executor except upon the written order of the Commissioner, and then only to the extent authorized by such order.

**210 Art. 77. Attorneys must have authorization.**—In all cases where information is sought regarding an estate, or an interview asked, by an attorney whose name does not appear on Form 706 as the attorney for the estate, or by any agent of the executor or administrator, the information or interview will be denied unless the attorney or agent presents a signed statement from the executor or administrator authorizing him to act in his behalf. Where his name as attorney for the estate appears on Form 706, his identity must be established. If an attorney or other person asks a ruling on a question of law arising in a specific estate, the Commissioner may require satisfactory evidence of the right to obtain such ruling.

**211** For regulations governing the recognition of attorneys, agents, and other persons representing claimants and executors before the Treas-



## ESTATE TAX REGULATIONS, ETC.

ury Department, reference should be made to Treasury Department Circular No. 230, dated April 25, 1922, copies of which may be obtained on application to the chief clerk of the Treasury Department. [See following Art. 1006, Reg. 62, in The Income Tax Service.]

## RETURN BY COLLECTOR.

**212** Art. 78. **Return by collector or Commissioner.**—Where there is no  
 33 duly qualified executor or administrator, or no return is filed within  
 8071 one year after the decedent's death, or if a filed return contains a  
 false or incorrect statement of a material fact, the collector or deputy  
 collector may make a return from such information as he possesses or is able  
 to obtain. The Commissioner may also make a return in such cases, or amend  
 any return made by a collector or deputy collector, and any return so made or  
 amended, or made by a collector or deputy collector and approved by the  
 Commissioner, shall be prima facie good and sufficient for all legal purposes,  
 and the Commissioner will assess the tax in the same manner as though the  
 return had been filed by the person on whom the duty to make the return  
 rested.

## PAYMENT OF TAX AND INTEREST.

**213** Art. 79. **Payment of tax; general.**—While no interest may be added  
 34 to the tax unless payment thereof has not been made within one year  
 36 and six months after decedent's death, the tax itself is due and must  
 be paid within one year after the decedent's death unless an extension  
 of time for the payment thereof has been granted by the Commissioner. No  
 discount will be allowed for payment in advance of the due date. The col-  
 lector will grant to the person paying the tax duplicate receipts, either of  
 which will be sufficient evidence of such payment, and entitle the executor  
 to be credited with the amount by any court having jurisdiction to audit or  
 settle his accounts.

**214** Payment of the amount of tax shown to be due by a return made in  
 good faith will be considered payment of the tax in full, subject,  
 however, to adjustment resulting from an investigation of the estate. If the  
 return is not made in good faith, the payment of the amount of tax shown to  
 be due thereby will not be deemed to be payment in full of the tax, but in-  
 terest will attach, and penalties will be imposed, as set forth in articles 83 and  
 89.

**215** Following an investigation of the estate the tax liability will be finally  
 determined by the Commissioner upon the basis of such investigation.  
 If at the time the Commissioner's determination is made the tax has been  
 paid upon the basis of the return, an adjustment will be made of the amount  
 of tax. If the amount of tax already paid exceeds the amount of tax as finally  
 determined, the Commissioner will refund such excess. If the amount of tax  
 as finally determined exceeds the amount of tax already paid, the collector  
 will notify the executor of the amount of the unpaid balance of the tax and  
 demand payment thereof. Payment should be made by the executor im-  
 mediately upon the receipt of such notification. When the investigation of  
 the return shows that no further tax is due, the executor will be notified to  
 that effect. Until the receipt of such notification, he should reserve a sufficient  
 portion of the estate to satisfy any additional tax.

[Payment of tax within one year under Revenue Act of 1918, ¶312.]

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**216 Art. 80. Payment by bonds or uncertified check.**—Payment of the estate tax may be made with bonds or notes (including Victory Notes and Treasury Notes) of the United States bearing interest at a higher rate than 4 per centum per annum, provided they were owned by the decedent continuously for at least six months prior to the date of his death, and constituted a part of his estate at death. Such bonds and notes are receivable at par and interest accrued at the time of the payment. When such bonds or notes are to be tendered in payment of estate taxes, a copy of either Department Circular No. 225 [¶358 herein], as heretofore or hereafter supplemented should be procured and the requirements thereof carefully noted.

**217** Collectors may accept uncertified checks in payment of estate taxes, provided such checks are collectible at par, that is, for their full amount, without any deduction for exchange or other charges. The collector will stamp upon the face of each check before deposit thereof the words, "This check is in payment of an obligation to the United States and must be paid at par. No protest," with his name and title. The day on which the collector receives the check will be considered the date of payment so far as the taxpayer is concerned, unless the check is returned dishonored. If the bank on which any such check is drawn should refuse to pay it at par, the check should be returned through the depository bank and be treated in the same manner as a bad check. All expenses incident to the attempt to collect such a check and the return of it through the depository bank must be paid by the drawer of the check to the bank on which it is drawn, since no deduction can be made from amounts received in payments of taxes. See Section 3210 of the Revised Statutes. If any taxpayer whose check has been returned uncollected by the depository bank should fail at once to make the check good, the collector should proceed to collect the tax as though no check had been given. A taxpayer who tenders a certified check in payment of taxes is also not released from his obligation until the check has been paid. See chapter 191 of the Act of March 2, 1911.

**218** Treasury Department Circular No. 176, as amended, prescribes detailed regulations governing the deposit and collection of checks. Collectors are referred to paragraphs 13-16 and paragraph 26 thereof as to the deposit of taxpayers' checks and the handling of uncollected or lost items.

**219 Art. 81. The executor shall pay the tax.**—The statute provides that the executor or administrator shall pay the tax. This duty applies to the entire tax, regardless of the fact that the gross estate consists in part of property which will not come into his possession. Where there is no duly qualified executor or administrator, all persons in actual or constructive possession of any property of the decedent are liable for and required to pay the tax to the extent of the value of such property. See, also, Article 86. As to the personal liability of the executor, see Article 99.

**220 Art. 82. Extension of time for payment.**—In any case where the Commissioner finds that payment of the tax within one year after the decedent's death would impose undue hardship upon the estate, an extension or extensions of time will be granted by him for the payment of the tax for a period not to exceed in all three years from the due date. Extensions of time for tax payment will be granted only in exceptional cases, where it is evident that the payment of the tax within the statutory period would cause the estate serious financial loss. No single extension for more than one year



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will be granted. Application for extension of time for payment should be filed with the collector, and should contain a full statement of the facts upon which the application is based. The collector will refer the application to the Commissioner, with suitable recommendations.

**221** An extension of time to pay the tax does not relieve from the duty of filing the return within one year from the date of death, nor will it operate to prevent interest from accruing as provided in the statute.

**222** **Art. 83. Interest on tax.**—Sections 406 and 407 contain the only provisions relating to interest on estate tax and consequently all questions of this character must be determined in accordance therewith. Section 407 deals with interest upon *additional* tax, and applies only to cases where the amount of tax shown upon a return made in good faith is fully paid within one year and six months after decedent's death, or time for payment of any portion thereof is extended beyond such period, and where after the lapse of such year and six months, the Commissioner determines that the correct amount of tax is in excess of that indicated by such return. The additional tax so determined, if not paid within one month after notice and demand by the collector, bears interest at the rate of 10 per centum per annum from the expiration of such time until payment is received by the collector.

**223** All other cases fall within, and are governed by, the provisions of Section 406. Thus, where any portion of the tax shown upon a return made in good faith is not paid within one year and six months following decedent's death, interest accrues thereon, though an extension of time for payment may have been granted, at the rate of 6 per centum per annum from the due date (one year after decedent's death) until payment is received by the collector. Likewise, in the case of a return so made and where no extension of time for payment is granted, so much of the entire tax (that is, the amount of tax as finally determined by the Commissioner, whether determined by him before or after the expiration of such period of one year and six months following the decedent's death, and whether the amount so determined be greater or less than that shown upon the return) as is not paid within such period bears interest at the rate of 6 per centum per annum from the due date until payment is received by the collector.

**224** Where the return is not made in good faith, Section 407 has no application, even though an extension of time may have been procured, and hence in all such cases any portion of the entire tax not paid within such period of one year and six months following decedent's death bears interest at the rate of 6 per centum per annum from the due date of the tax (one year after decedent's death) until payment thereof is received by the collector.

## COLLECTION OF TAX.

**225** **Art. 84. Remedy not exclusive.**—The remedy by action, here [¶39] provided, is not exclusive. For other available remedies for the collection of the tax, see Article 102.

## REIMBURSEMENT.

**226** **Art. 85. Right to reimbursement not enforceable by Commissioner.**—  
**40** Where any portion of the tax is paid by, or collected out of that part of the estate passing to, or in the possession of, any person other than the duly qualified executor or administrator, such person may be entitled to re-



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imbursement, either out of the undistributed estate or by contribution from other beneficiaries whose shares or interests in the estate would have been reduced had the tax been paid before distribution of the estate, or whose shares or interests are subject either to an equal or prior liability for the payment of taxes, debts, or other charges against the estate. The executor is also entitled to require beneficiaries under insurance policies to bear their proportion of the tax. These provisions, however, are not designed to curtail the right of the Commissioner to collect the tax from any person, or out of any property, liable therefor. The Commissioner can not be required to apportion the tax among the persons liable, nor to enforce any right to reimbursement or contribution. For example, where a transfer has been made in contemplation of death, the Commissioner may hold both the executor and the transferee liable for the tax with respect to the property transferred. In such case, if the tax is paid by the executor, he may not look to the Commissioner for relief by refund of part of the tax.

## LIEN.

**227** Art. 86. Property subject to lien.—This lien attaches to every part  
38 of the gross estate, whether or not the property comes into the pos-  
41 session of the duly qualified executor or administrator. It attaches  
to the extent of the tax shown to be due by the return and of any  
additional tax found to be due upon investigation.

**228** Where the decedent transferred or placed in trust property in con-  
templation of or intended to take effect in possession or enjoyment  
at or after his death (except in the case of a bona fide sale for a fair con-  
sideration in money or money's worth), and where proceeds of insurance on  
his life passed to a specific beneficiary other than the duly qualified executor  
or administrator, a lien attaches thereto to the amount of the tax in respect  
to the particular property or money received by such transferee, trustee, or  
insurance beneficiary, and such transferee, trustee, or insurance beneficiary  
is personally liable for such tax. Where the transferee or trustee sells the  
property to a bona fide purchaser for a fair consideration in money or money's  
worth the lien upon the property is divested; but there is substituted a like  
lien upon all the property of such transferee or in case of such transfer by a  
trustee upon all the assets of the trust estate, except such part as may be  
sold to a bona fide purchaser for such a consideration.

**229** The lien upon the entire property constituting the gross estate con-  
tinues for a period of 10 years after the decedent's death, except—

(1) Where the tax is paid in full before the expiration of such period;  
(2) Such portion of the gross estate as is used for the payment of charges  
against the estate and expenses of its administration allowed by any court  
having jurisdiction thereof;

(3) Such portion of the gross estate as has passed to a bona fide purchaser  
for value after payment of the full amount of tax determined by the Com-  
missioner pursuant to a request of the executor, as authorized by Section 407,  
for discharge from personal liability (see Art. 72);

(4) Such property as has been sold by any transferee or trustee to a bona  
fide purchaser for a fair consideration in money or money's worth, where such  
property was received from the decedent as a transfer in contemplation of,  
or intended to take effect in possession or enjoyment at or after, his death  
(except in the case of a bona fide sale for a fair consideration in money or  
money's worth);

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(5) Where the Commissioner issues his certificate releasing such lien (see Art. 87).

**230 Art. 87. Release of lien.**—The statute provides that, if the Commissioner is satisfied that the tax liability of an estate has been fully discharged or provided for, he may issue his certificate releasing any or all property of the estate from the lien. The issuance of certificates is a matter resting within the discretion of the Commissioner, and certificates will be issued only in case there is actual need therefor. In most cases the receipts issued by the collector constitute sufficient acquittance.

**231** The tax will be considered fully discharged for the purpose of the issuance of a certificate only when investigation has been completed, and payment of the tax, as determined by the Commissioner, has been made. A certificate of release of lien may be issued by the Commissioner under these circumstances as to any or all property of the estate, upon the filing by the executor of an application in duplicate on Form 791. The form must contain all the information called for.

**232** Where the tax liability has not been fully discharged, as provided above, no general certificate of release will be granted, but releases of lien upon particular items of property will be issued upon the filing with the Commissioner of such security, if any, as he may require. Where security is required, a corporate indemnity bond must be furnished, or Liberty Bonds, or other bonds or notes of the United States, must be deposited with the collector. In lieu of such security, the Commissioner may in any case issue the release upon payment of the estimated tax upon the transfer of the property released, computed at the highest rate applicable to the estate. If, upon consideration of the application, the Commissioner finds the issuance of the certificate to be warranted, the collector will notify the executor of the amount of the bond, as fixed by the Commissioner.

[Transfer of stock: lien on stock and release of lien, ¶393.]

## PENALTIES.

**233 Art. 88. Nature of penalties.**—Two kinds of penalties are provided for delinquency with respect to the duties imposed by the estate tax law:

(1) A specific penalty, to be recovered by suit, unless paid on demand, or adjusted by an acceptance of an offer in compromise; and

(2) A penalty of a certain percentage of the tax, to be added to the tax and collected in the same manner as the tax.

**234** In any case where more than one penalty is provided, the Government may impose any one or more thereof.

**235 Art. 89. Penalties for false or fraudulent notice or return.**—Where statements in the notice required by Section 404, or in the return, are knowingly and willfully false, the person making them is subject to a penalty not exceeding \$5,000, or imprisonment for not exceeding one year, or both; and, for a false or fraudulent return, 50 per centum may be added to the amount of the tax.

**236 Art. 90. Penalty for failure to file notice or return.**—For failure to file the notice or the return within the time prescribed, the person in default is subject to a penalty not to exceed \$500; and, for the failure to file the return within the time prescribed, 25 per centum may be added to the amount of the tax, unless the failure so to file the return was due to a reasonable cause and not to willful neglect.



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**237**    **Art. 91. Penalty for failure to exhibit records or property.**—Where a person in possession or control of any record, file, or paper, supposed to contain information relating to the estate, or having in his possession or control property comprised in the gross estate of the decedent, fails to exhibit the same, upon the request of the Commissioner or any collector or law officer of the United States, or his duly authorized deputy or agent, in the performance of his duties, he is liable to a penalty not to exceed \$500, to be recovered by civil action. He must comply with such a request whether or not he believes that the documents contain information relating to the estate.

**CLAIMS FOR ABATEMENT AND REFUND.**

**238**    **Art. 92. Kinds of relief.**—Two forms of relief are afforded the executor in cases where he believes that an excessive amount of tax or  
**8023**    an illegal penalty has been assessed or paid either upon the basis of  
**8047**    the return or of the investigation conducted by the Bureau. The  
**8050**    two forms of relief are:

- (1) Claim for abatement, where the alleged excessive tax or illegal penalty has been assessed but not paid.
- (2) Claim for refund, where such tax or penalty has been paid.

**239**    **Art. 93. Claim for abatement.**—Claims for the abatement of taxes or penalties illegally assessed must be made upon Form 843, and must be sustained by the affidavit of the executor or other parties cognizant of the facts. When a tax or penalty has been assessed, the presumption is that the assessment is correct; and the burden of showing that it was improperly or illegally assessed rests upon the applicant for abatement. The affidavit must therefore contain a full and explicit statement of all the material facts relating to the claim in support of which it is offered in order that the claim may receive proper consideration. Nothing should be left to inference, but all the facts relied upon should appear in the papers themselves. The filing of a claim for the abatement of a tax or penalty alleged to have been erroneously or illegally assessed does not necessarily operate as a suspension of the collection thereof. The collector may proceed to collect if he thinks it necessary, and leave the taxpayer to his remedy by a claim for refund.

**240**    **Art. 94. Accrual of interest as affected by abatement claim.**—Where a claim for abatement is rejected, the making of the application does not affect the running of interest. The allowance of the claim, however, in whole or part, discharges all liability for interest upon the portion of the claim allowed. The same rules apply where, upon the request of the executor, a reinvestigation is made.

**241**    **Art. 95. Limitation of time to file claim for abatement of additional tax.**—If it is desired to file claim for abatement of the additional amount of tax disclosed upon an investigation, such claim must be filed with the collector within one month after receipt by the executor of the Commissioner's letter of notification. After that period the claim will not be considered, but the tax must be paid, and adjustment sought by claim for refund.

**242**    **Art. 96. Claim for refund.**—Claims for the refunding of estate taxes imposed by any of the several Revenue Acts, and of penalties in



## ESTATE TAX REGULATIONS, ETC.

respect thereto, which are alleged to have been collected without legal authority, must be presented to the Commissioner within four years next after payment thereof. Such claims must be made on Form 843. As in the case of claims for abatement, the burden of proof rests upon the claimant. All the facts relied upon in support of the claim should be clearly set forth under oath. With the claim should be presented, in addition to the evidence:

(1) Where the claim is made by an executor or administrator, a certificate of the court showing that the appointment remains in full force and effect.

(2) Where the executor or administrator has been discharged and no administrator de bonis non has been appointed and qualified, there should be submitted, in lieu of the certificate above mentioned, (a) a certified copy of the court order granting the discharge, and, (b) a certified copy of the order of distribution, or, if such order does not fully disclose the identity of the person or persons entitled to receive any amount that may be refunded and the percentage or proportion thereof to which each, if more than one, is entitled, there should be submitted a certified copy of the decedent's will, if any, and such further proof as may be requisite to establish both the identity of such person or persons and the percentage or proportion of the amount sought to be refunded to which each, where there are more than one, is entitled.

(3) Where a claim is filed after the administration of the estate has been closed, and is signed by one only, or by less than all, of a number of beneficiaries entitled to share in the refund, or is signed by a person acting as attorney or agent for the interested parties, there must accompany the claim, in addition to the proof required in paragraph (2) above, a power of attorney, duly executed by all beneficiaries entitled to any portion of the repayment, authorizing the claimant or claimants to present the matter before the Bureau.

**243 Art. 97. Payment of claims and interest.**—Warrants in payment of claims allowed will be drawn to the order of the person or persons entitled to the proceeds, and will be forwarded directly to such person or persons by the Treasurer of the United States, except where delivery to an attorney or agent has been authorized in accordance with the regulations contained in Treasury Department Circular No. 230 [see following Art. 1006, Reg. 62, in *The Income Tax Service*], dated April 25, 1922, as heretofore or hereafter amended or supplemented. If the claimants are indebted to the United States for taxes, such taxes must be paid before the warrants are delivered. (Act of Mar. 3, 1875 (18 Stats. 481).)

**244** On the allowance of a claim for refund of taxes paid Section 1324 of the statute provides for the payment of interest upon the total amount of such refund at the rate of one-half of 1 per centum per month to the date of such allowance, as follows: (1) If such amount was paid under a specific protest setting forth in detail the basis of and reasons for such protest, from the time when such tax was paid, or (2) if such amount was not paid under protest but pursuant to an additional assessment, from the time such additional assessment was paid, or (3) if no protest was made and the tax was not paid pursuant to an additional assessment, from six months after the date of filing of such claim for refund.

### POWER TO COMPROMISE OR REMIT PENALTIES.

Revised Statutes, Sec. 3229 (Comp. Sts., 1916, Sec. 5952). The Commissioner of Internal Revenue, with the advice and consent of the Secretary of the Treasury, may

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## ESTATE TAX REGULATIONS, ETC.

compromise any civil or criminal case arising under the internal-revenue laws instead of commencing suit thereon; and, with the advice and consent of the said Secretary and the recommendation of the Attorney General, he may compromise any such case after a suit thereon has been commenced. Whenever a compromise is made in any case there shall be placed on file in the office of the Commissioner the opinion of the Solicitor of Internal Revenue, or of the officer acting as such, with his reasons therefor, with a statement of the amount of tax assessed, the amount of additional tax or penalty imposed by law in consequence of the neglect or delinquency of the person against whom the tax is assessed, and the amount actually paid in accordance with the terms of the compromise.

**Revised Statutes, Sec. 5292** (Comp. Sts., 1916, Sec. 10,130). Whenever any person who shall have incurred any fine, penalty, or forfeiture, or disability \* \* \* shall refer his petition to the judge of the district in which such fine, penalty, or forfeiture, or disability has accrued, truly and particularly setting forth the circumstances of his case, and shall pray that the same may be mitigated or remitted, the judge shall inquire, in a summary manner, into the circumstances of the case; first causing reasonable notice to be given to the person claiming such fine, penalty, or forfeiture, and to the attorney of the United States for such district, that each may have an opportunity of showing cause against the mitigation or remission thereof; and shall cause the facts appearing upon such inquiry to be stated and annexed to the petition, and direct their transmission to the Secretary of the Treasury. The Secretary shall thereupon have power to mitigate or remit such fine, forfeiture, or penalty, or remove such disability, or any part thereof, if, in his opinion, the same was incurred without willful negligence, or any intention of fraud in the person incurring the same; and to direct the prosecution if any has been instituted for the recovery thereof, to cease and be discontinued, upon such terms or conditions as he may deem reasonable and just.

**Revised Statutes, Sec. 5293** (Comp. Sts., 1916, Sec. 10,131). The Secretary of the Treasury is authorized to prescribe such rules and modes of proceeding to ascertain the facts upon which an application for remission of a fine, penalty, or forfeiture, is founded, as he deems proper, and, upon ascertaining them, to remit the fine, penalty, or forfeiture, if in his opinion it was incurred without willful negligence or fraud, in either of the following cases:

First. If the fine, penalty, or forfeiture was imposed under authority of any revenue law, and the amount does not exceed \$1,000. \* \* \*

**245** **Art. 98. Power to compromise or remit.**—The Commissioner, with  
**8059** the advice and consent of the Secretary of the Treasury, may compromise any civil or criminal case arising under the internal-revenue laws instead of commencing suit thereon, and with the advice and consent of the Secretary, and upon the recommendation of the Attorney-General, may compromise any such case after suit thereon has been commenced by the United States. Accordingly, the power to compromise extends to (a) both civil and criminal cases; (b) cases whether before or after suit; and (c) both taxes and penalties, except that taxes legally due from a solvent taxpayer may not be compromised. Refunds can not be made of accepted offers in compromise in cases where it is subsequently ascertained that no violation of law was involved. Where a fine, penalty, or forfeiture, not exceeding \$1,000, is incurred without willful negligence or fraud, it may be remitted by the Secretary of the Treasury; and he may mitigate or remit other fines, penalties, forfeitures, and disabilities where the court has inquired into the matter and made findings.

## PERSONAL LIABILITY OF EXECUTOR.

**Revised Statutes, Sec. 3467** (Comp. Sts., 1916, Sec. 6373). Every executor, administrator, or assignee, or other person, who pays any debts due by the person or estate from [for] whom or for which he acts, before he satisfies and pays the debts due to the United States from such person or estate, shall become answerable in his own person and estate for the debts so due to the United States, or for so much thereof as may remain due and unpaid.



## ESTATE TAX REGULATIONS, ETC.

**246** **Art. 99. Extent of liability.**—The executor is personally liable for  
 34 the payment of the estate tax to the amount of the full value of the  
 assets of the estate which have at any time come into his hands.  
 Where no executor or administrator has been appointed, every person in  
 actual or constructive possession of any property of the decedent is liable  
 for the tax as an executor to the value of such property, except as limited by  
 Article 87 in the case of transferees, trustees and insurance beneficiaries.

## EXAMINATION OF RECORDS AND TAKING OF TESTIMONY.

**247** **Art. 100. Securing evidence—Taking testimony.**—In order to ascer-  
 8002 tain the correctness of a return, or to make a return where none  
 8003 has been made, the Commissioner has power to require the attend-  
 ance, and to take the testimony, of the person rendering the return,  
 or any officer or employee of such person, or any other person having knowl-  
 edge in the premises. Such persons may be required to produce any relevant  
 book, paper, or other record. This power may be exercised by any revenue  
 agent or inspector designated for the purpose.

**248** **Art. 101. Power to compel compliance.**—Where any person is sum-  
 moned to appear and testify, or to produce books, papers, or other  
 data, the District Court of the United States for the district in which such  
 person resides has power to compel the giving of the testimony, or the  
 production of the books, papers, or data, and to issue any appropriate process,  
 writ, or order.

## REMEDIES FOR COLLECTION.

**249** **Art. 102. Remedies for collection of tax.**—The provisions of the  
 8000 statute quoted above apply to the estate tax law; and three remedies  
 8001 are thus provided for the collection of the tax:

(1) *Collection by distraint.*—The collector may issue warrant of  
 distraint authorizing the seizure and sale of any or all of the assets of the  
 estate. (See R. S., Secs. 3187 et seq.; Comp. Sts., 1916, Sec. 5909 et seq.)

(2) *Collection by suit to subject the property to sale.*—The collector may com-  
 mence in any court of the United States appropriate proceedings, in the name  
 of the United States, to subject the property of the decedent to sale under  
 the judgment or decree of the court.

(3) *Collection by suit for personal liability.*—The personal liability of the  
 executor, of the transferee or trustee of property transferred in contemplation  
 of or intended to take effect in possession or enjoyment at or after decedent's  
 death, and of the beneficiary of life insurance, may be enforced by any  
 appropriate action.

**250** **Art. 103. Executor's duty to keep records.**—It is the duty of the  
 executor to keep such records as the Commissioner may require.  
 Executors are required to keep such complete and detailed records of the  
 affairs of the estate as will enable the Commissioner to determine accurately  
 the amount of the tax liability.

**251** **Art. 104. Executor's duty to render statements.**—It is the duty of the  
 executor not only to make the formal return, but also to render any  
 other sworn statement which the Commissioner may require for the purpose  
 of determining whether a tax liability exists.



## ESTATE TAX REGULATIONS, ETC.

ESTATES ADMINISTERED IN THE UNITED STATES COURT  
FOR CHINA.

**252** [Repeats the law merely.—Sec. 411, ¶45-47.]

## SCOPE OF REPEAL.

**253** Art. 105. Scope of repeal.—The Revenue Act of 1921 retains in force the provisions of Title IV of the Revenue Act of 1918 for the assessment and collection of all taxes accruing thereunder, and for the imposition and collection of all penalties which have accrued or may accrue in relation to any such taxes.

**254** Art. 106. Promulgation of regulations.—In pursuance of the statute, the foregoing regulations are hereby made and promulgated, and all rulings inconsistent herewith are hereby revoked. These regulations apply to all pending estate tax cases except where a particular question is governed by a specific provision of the earlier statutes differing from the Revenue Act of 1921, in which cases the provisions of the applicable statute control and Regulations 37 (revised January, 1921) remain in full force and effect, subject to the following changes:

Article 47 is amended to read as follows:

The unpaid principal of mortgages on property of the decedent, whether the property be situated within or without the United States, including interest accrued to the date of death, is deductible.

Articles 29, 71, and 76-A are revoked.

D. H. BLAIR,

*Commissioner of Internal Revenue.*

Approved July 27, 1922. [Released for publication August 7, 1922.]

A. W. MELLON,

*Secretary of the Treasury.*

## ESTATE TAX REGULATIONS, ETC.

**255 LIST OF THE SEVERAL DIVISIONS AND LOCATIONS OF OFFICES OF INTERNAL REVENUE AGENTS IN CHARGE.**

(Communications should be addressed:  
 United States Internal Revenue Agent in Charge,  
 ..... )  
 City. State.

Name of division.	Territory embraced.	Location of office.
Atlanta.....	Florida and Georgia.....	Atlanta, Ga.
Baltimore.....	Delaware, District of Columbia, Maryland.	Baltimore, Md.
Boston.....	Maine, Massachusetts, New Hamp- shire, and Vermont.	Boston, Mass.
Buffalo.....	Twenty-first and twenty-eighth col- lection districts of New York.	Buffalo, N. Y.
Chicago.....	First collection district of Illinois...	Chicago, Ill.
Cincinnati.....	First and eleventh collection districts of Ohio.	Cincinnati, Ohio.
Cleveland.....	Tenth and eighteenth collection dis- tricts of Ohio.	Cleveland, Ohio.
Columbia.....	South Carolina.....	Columbia, S. C.
Denver.....	Arizona, Colorado, New Mexico, and Wyoming.	Denver, Colo.
Detroit.....	Michigan.....	Detroit, Mich.
Greensboro.....	North Carolina.....	Greensboro, N. C.
Honolulu.....	Hawaii.....	Honolulu, Hawaii.
Huntington.....	West Virginia.....	Huntington, W. Va.
Indianapolis.....	Indiana.....	Indianapolis, Ind.
Louisville.....	Kentucky.....	Louisville, Ky.
Milwaukee.....	Wisconsin.....	Milwaukee, Wis.
Nashville.....	Alabama and Tennessee.....	Nashville, Tenn.
Newark.....	New Jersey.....	Newark, N. J.
New Haven.....	Rhode Island, Connecticut, and fourteenth collection district, New York (except Westchester County, and the twenty-third and twenty- fourth wards of New York City).	New Haven, Conn.
New Orleans.....	Louisiana and Mississippi.....	New Orleans, La.
New York.....	First and second collection districts of New York, Westchester County and twenty-third and twenty- fourth wards of New York City being part of the fourteenth collec- tion district of New York.	New York City.
Oklahoma.....	Arkansas and Oklahoma.....	Oklahoma, Okla.
Omaha.....	Iowa and Nebraska.....	Omaha, Nebr.
Philadelphia.....	First and twelfth collection districts of Pennsylvania.	Philadelphia, Pa.
Pittsburgh.....	Twenty-third collection district of Pennsylvania.	Pittsburgh, Pa.
Richmond.....	Virginia.....	Richmond, Va.
St. Louis.....	Missouri.....	St. Louis, Mo.
St. Paul.....	Minnesota, North Dakota and South Dakota.	St. Paul, Minn.
Salt Lake City.....	Idaho, Montana, and Utah.....	Salt Lake City, Utah.
San Antonio.....	Texas.....	San Antonio, Tex.
San Francisco.....	California and Nevada.....	San Francisco, Calif.
Seattle.....	Washington, Oregon and Alaska...	Seattle, Wash.
Springfield.....	Eighth collection district of Illinois..	Springfield, Ill.
Wichita.....	Kansas.....	Wichita, Kans.



## INDEXED SUPPLEMENTARY ESTATE TAX REGULATIONS, ETC.

*Forward references to which are embodied in the foregoing Regulations 63.*

## INDEXED SUPPLEMENTARY ESTATE TAX REGULATIONS,

## RULINGS, DECISIONS, ETC.,

## TO WHICH

## FORWARD REFERENCES ARE EMBODIED IN THE FOREGOING

## REGULATIONS 63.

**256** Household effects and like personalty used by husband and wife

96 in the marriage relation are presumed to be the property of the husband, and, in the absence of sufficient evidence to rebut this presumption must be returned as a portion of his gross estate.—In reviewing returns on Form 706 in this office, it is found that oftentimes there are reported no household goods or other miscellaneous personalty of that character. This fact is brought to the attention of the examining officer, and in most cases results in the discovery of the existence of such property belonging to the estate of the decedent. In other cases the examining officers have been reporting the substance of the following: "Widow of deceased claims the household effects, etc., as her own separate property."

**257** Statements to the above effect, unexplained, are not sufficient to relieve the estate from returning and paying tax upon the household furniture used by the decedent in the household occupied by himself and wife. Upon the decease of a husband the household goods and other chattels used by husband and wife in the marriage relation are presumed to be the property of the husband. If the wife claims the same as her separate property, she has the burden of establishing that claim.

**258** There are certain situations where the widow's claim will not be questioned and will consequently relieve the estate from returning the household goods as part of the gross estate of the deceased husband. All that is required in such cases is *sufficient evidence* of the existence of the facts in question. Such situations are as follows: (1) Where the articles of household furniture were owned by the wife prior to marriage; (2) where the wife has purchased the household effects during coverture with her separate funds; (3) where the household effects represent gifts from a third person to the wife individually during coverture.

**259** It is not at all uncommon, however, that the household effects have been purchased by the husband since the marriage and at his death the wife claims that the decedent made her a gift of the various articles during the marriage, although the articles have never left the possession of the husband—*i. e.*, they remain in the household occupied by the husband and wife and are used by them jointly. Such property is presumed to be owned by the husband, and if the wife, or any other person for that matter, claims the household effects as a gift from the deceased the burden of proving the gift rests upon the person asserting it. A gift from husband to wife must be clearly established. There must be clear and incontrovertible evidence of the delivery of the property by the husband with the intention of divesting himself of all dominion and control and of vesting title in the wife. The requirements necessary to a valid executed gift must be present. If the gift be in contemplation of death, of course another question would arise.

**260** The following proposition has been announced by the courts and is believed by this office to be sound: To constitute a valid gift



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there must be an absolute transfer of the property from donor to donee, taking effect immediately, and fully executed by a delivery of the property by the donor, and the acceptance thereof by the donee. It is essential that the transaction should be fully executed by the delivery of the property to the donee, or to some person for him. In several States statutes have been enacted providing that no gift, except by deed or will, shall be valid unless actual possession shall come to and remain with the donee or his agent, and if the donor and donee reside together at the time of the gift, possession by the donee at their place of residence is not a sufficient possession within the meaning of the statute.

**261** The foregoing should be carefully considered when examining officers are investigating the completeness and accuracy of estate tax returns. (T. D. 2529, Oct. 4, 1917.)

**262** Bequest or devise in lieu of dower: Decision of Court: Act of September 8, 1916.—Constitutionality of Act: Title II, Act of September 8, 1916, imposing an estate tax, is constitutional. Decision of the United States Supreme Court in *New York Trust Co. v. Eisner*, 41 Sup. Ct. 506 [¶397], held controlling. Deduction; State Transfer Tax Not Deductible as a Charge Against the Estate: The New York State Transfer Tax is not a charge that affects "the estate as a whole." It diminishes each legacy bequeathed by decedent, and is therefore not "a charge against the estate" and may not be deducted from the gross estate under the provisions of Section 203 of the Revenue Act of 1916. Decision of the United States Supreme Court in *New York Trust Co. v. Eisner*, 41 Sup. Ct. 506 [¶397], held controlling.

Gross Estate; Bequest or Devise in Lieu of Dower: If a widow accepts a provision made in lieu of dower, the value of the property thus bequeathed or devised must be included in the gross estate, as defined in Section 203 of the Revenue Act of 1916, and the amount so included may not be diminished by deducting the value of the widow's dower in decedent's realty.

**263** (The appended decision [syllabus only] of the United States District Court for the Southern District of New York, in the case of *Title Guarantee & Trust Company and Minnie W. Teets*, as Executors of the Last Will and Testament of Joseph W. Teets, deceased, v. Edwards, Collector, the syllabus [¶262] of which appears above is published not as a ruling of the Treasury Department, but for the information of internal revenue officers and others concerned.) (T. D. 3319, April 5, 1922.)

## Community Property.

1. *Income taxes—Husband and wife—Community property.*

\* \* \* \* \*

**264** 2. *Estate tax—Husband and wife—Community property.*

**127** In Washington, Arizona, Idaho, New Mexico, Louisiana and Nevada there should be included in gross estate, in computing the estate tax of a deceased spouse, one-half only of the community property of husband and wife domiciled therein; this is not based upon any statute

## INDEXED SUPPLEMENTARY ESTATE TAX REGULATIONS, ETC.

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enacted subsequent to March 1, 1913, and applies under estate tax acts prior to the Revenue Act of 1918. [Captions to T. D. 3138, ¶265, below.]

**265** There is given below in full for your information and guidance an opinion rendered by the Attorney General under date of February 26, 1921, dealing with the right of husband and wife domiciled in certain states having so-called "community property" laws to divide certain of their income for the purpose of the income tax, and as to the inclusion of community property in the gross estate of a deceased spouse. See, in this connection, Treasury Decision No. 3071 [see ¶286]. (T. D. 3138, signed by Commissioner Wm. M. Williams, and dated March 3, 1921.)

**266** Dear Mr. Secretary: My opinion has been requested upon the following questions:

**267** 1. \* \* \* \* \*

**268** 2. In which of the states in which the community property system exists should there be included in gross estate, in computing the estate tax of the estate of a deceased spouse, one-half and only one-half of the community property of husband and wife domiciled therein? [See answer at ¶295.]

**269** 3. If your answers to questions 1 and 2, as to any state are based upon a statute enacted subsequent to March 1, 1913, please give the rule as to such state existing from March 1, 1913 to the passage of such statute, for my guidance in allowing claims for refund. [See answer at ¶296.]

**270** 4. Do your answers to questions 1 and 2 apply under income and estate tax acts prior to the Revenue Act of 1918? [See answer at ¶297.]

**271** The community property system prevails in Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas and Washington. The application of the income tax act to the income from community property belonging to husband and wife domiciled in Texas was disposed of in my opinion of September 10, 1920. [See ¶286].

**272** While the statutes of California are in some respects similar to the community property laws of the other community property states, the rule established by the highest courts of that state is that during coverture the wife has no vested interest in the community property, her interest therein being a mere expectancy.

**273** In *Spreckles v. Spreckles*, 116 Cal. 339 (1897), the Supreme Court of that state held that prior to the amendment of 1891 to Sec. 172 of the Civil Code, forbidding the husband to give away community property without consent of the wife in writing, the code vested in the husband all the elements of absolute ownership of the community property; that the wife's interest was a mere expectancy, and as to all the world except the wife, there was, prior to that amendment, no distinction between the community estate and the separate estate of the husband; and that the amendment could not be construed retroactively so as to deprive the husband of his vested right to dispose by gift of community property acquired prior to the amendment, without the consent of the wife.

**274** In 1905 California passed an inheritance tax law, and subsequently the question was raised whether a widow should be compelled to pay such tax on that one-half of the community property that she took on the death of her husband. In the *Estate of Moffitt*, 153 Cal. 359 (1908), the Supreme Court of California held that she did, since she had no vested



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interest in the community estate and took her one-half on the death of her husband as his heir.

**275** This case was taken to the Supreme Court of the United States (Moffitt v. Kelly, 218 U. S. 400) where the judgment of the lower court was affirmed, the court laying down the rule that the nature and character of the right of the wife in community property for the purpose of taxation is a peculiarly local question, and the determination of the state court in regard thereto is not reviewable by the Supreme Court; and, further, that the law of California of 1905, taxing all property passing by will or intestacy, having been construed by the highest court of that state as applying to the wife's share of the community property, such tax is not in conflict with the contract, due process, or equal protection clauses of the Constitution.

**276** Subsequently the inheritance tax law of California was amended to provide "that for the *purpose of this act*" the one-half of the community property which goes to the surviving wife on the death of her husband, under the provisions of Sec. 1402 of the Civil Code "shall not be deemed to pass to her as heir to her husband, but shall, for the purpose of this act, be deemed to go, pass, or be transferred, to her for valuable and adequate consideration."

**277** It is obvious that this language does not change the rule of community property in the state nor vest in the wife any interest thereto prior to the dissolution of the community; rather it emphasizes the existing rule that the wife has no vested interest in community property.

**278** As to the effect of Sec. 172a of the Civil Code, enacted in 1917, it is not to be presumed that the legislature intended, by the enactment of same to make so revolutionary a change in the existing rule of property in California as to divest the husband of his ownership in the community property. As was said in Spreckles v. Spreckles, supra, "If a husband cannot make a valid transfer of the property for the purpose of depriving his wife of it, that does not show a vested right in her;" and giving the fullest possible effect to the language, unless the wife had a vested interest by virtue of the law as it theretofore existed, which it must be conceded she did not, the operation of the amendment would necessarily be confined to community property acquired after May 23, 1917.

## SUMMARY.

**279** Summarizing, it appears that in all of the community property states except California their own courts have held that the wife has, during the existence of the marriage relation, a vested interest in one-half of the community property. Her rights in the property of the community are perhaps most fully recognized in the state of Washington, where both spouses have testamentary disposition over one-half of the community property, and where in the absence of such disposition it descends to their issue, or, in the absence of issue, to the survivor; while the husband is manager of the community estate in Washington he may not sell, convey, or encumber real estate unless the wife join with him in the conveyance; and as was held in Huyvaerts v. Roedtz, ante, and Schramm v. Steele, ante, the separate debt of the husband cannot be satisfied out of community property where it is not incurred in connection with the community business, nor for the benefit of the community.

**280** In Idaho it is seen that the limitation upon the alienation of the community real property is the same as in Washington. But while



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the wife's earnings and the rents and profits of her separate estate are community property she is given the management and control of same. The Idaho rule governing the disposition of community property on the death of either spouse is, with minor variations, the same as that of Washington. In neither state is an inheritance tax payable on the one-half of the community that goes to the one spouse on the death of the other.

**281** In **Arizona** the husband only may dispose of community personal property, but the wife must join him in deeds or mortgages affecting real estate, except unpatented mining claims. One-half of the community property is subject to the testamentary disposition of either spouse, and in absence of such disposition goes to his or her descendants; where there is neither testamentary disposition nor descendants, it is subject to distribution in the same manner as the separate property of the husband. On decree of divorce the Court may divide the property as he sees fit, but in the absence of provision for the community property the parties from the date of the decree holds as tenants in common. The courts of Arizona hold that the wife is equal owner with her husband.

**282** In **Nevada** the husband has the entire management and control of the community property, except that the wife has entire control of her earnings when living separate from her husband. Upon her death the husband takes the whole community estate, except that where he has abandoned her without good cause she may by will dispose of half and in absence of such disposition it goes to her heirs, exclusive of her husband. On the death of the husband the wife takes half and the husband may dispose of the other half by will, or it goes to his surviving children; if there is no will and no children survive, the whole goes to the wife without administration, subject to certain provisos. On dissolution of community by divorce for any other ground than adultery or extreme cruelty, the community property must be equally divided between the parties. The wife pays no inheritance tax under the inheritance tax law of Nevada on her interest in community property the courts holding that she takes not as heir but by a right vested in her at all times during marriage. It is to be noted that the Constitution of Nevada recognizes the wife's interest in community property.

**283** In **New Mexico** while the husband is manager of the community estate, he may not transfer real property without a valuable consideration without the written consent of his wife; and under certain circumstances the wife may be substituted as manager; prior to 1915 he could not transfer community personal property except for a valuable consideration without her written consent; on dissolution of the community by the death of the wife the husband takes all except such portion as may have been set aside to the wife by judicial decree, which portion goes to her heirs unless she has disposed of same by will; on death of the husband one-half goes to the wife and the other half is subject to testamentary disposition by the husband. If he makes no will one-fourth of his one-half goes to the wife and the remainder to the children. On separation either may petition for division of community property and after divorce continue to hold as tenants in common where no disposition has been made in the divorce decree. New Mexico has no state inheritance-tax act.

**284** In **Louisiana** the community property comprehends all property acquired during the marriage by either husband or wife except that

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acquired with separate funds or by inheritance or particular donation, and excepting the earnings of the wife when she is living separate from her husband; the husband is manager of the community but he may not convey community immovables by gratuitous title, and cannot dispose of moveables in fraud of the wife; either spouse may dispose of one-half the community property by will and the laws governing the descent of such property in the absence of testamentary disposition apply equally to both spouses, the survivor taking the deceased spouse's half by inheritance when there is no will, and neither father, mother or descendants. As heretofore stated the survivor pays no inheritance tax on his or her one-half of the community property but does pay on that part inherited from the deceased spouse.

**285** In California the wife has no power of testamentary disposition of community property except of such as may have been set aside to her by judicial decree; she takes one-half as heir on the death of the husband; but on the death of the wife the entire community property belongs to the husband without administration. The California courts have held that under the law as it stood prior to 1917 the wife had no vested interest in community property prior to the dissolution of the marriage; the amendment to the inheritance tax act being limited to the purposes of that act could not have had the effect of vesting an interest in her, and had the addition of Sec. 172a had that effect any amendment of the inheritance tax act would have been unnecessary to exempt her one-half from taxation thereunder. In the case of *Blum v. Wardell*, now pending before the Circuit Court of Appeals of the Ninth Circuit, on appeal from the District Court of the Northern District of California, the application of the Federal estate tax act of 1916 is under consideration.

**286** As appears from my opinion of September 10, 1920, in Texas the control of community property is divided between the husband and wife; in that state on the death of either spouse without issue the survivor takes the whole and where there is issue, takes one-half, the other half going to said issue or their descendants. Under the state inheritance tax law the wife pays no tax on her half of the community property.

**287** In *Warburton v. White*, 176 U. S. 484, 496, the principle was enunciated that where state decisions have interpreted state laws governing property or controlling relations that are essentially of a domestic and state nature the United States Supreme Court will follow the state decisions if possible to do so, in the discharge of its duties. Also in *De Vaughn v. Hutchinson*, 165 U. S. 566, 570, it was held that to the law of the state in which property is situated we must look for the rules which govern its descent, alienation and transfer, and for the effect and construction of wills and other conveyances. In *United States v. Crosby*, 7 Cranch 115, it was held that the title to land can be acquired and lost only in the manner prescribed by the law of the place where same is situated.

**288** In arriving at an answer to the questions propounded by you we are called upon to determine the rules of property in the community property states; we have, therefore, pursuant to the rules of the above cases, adopted the rules laid down by the highest courts of the various states. There remains to be determined the application thereto, of the income and estate tax provisions of Federal statutes. In my previous opinion it was stated that since in Texas the ownership in one-half of all community property vests in each spouse, whatever is income to the community is income to both.



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*Forward references to which are embodied in the foregoing Regulations 63.*

This conclusion applies, therefore, to all states in which community property is held to be vested equally in both spouses.

**289** Section 201 of the Revenue Act of 1916 and Sec. 401 of that of 1918 impose a tax "upon the transfer of the net estate of every decedent" dying after the passage thereof, to be determined as is set forth in the sections following, which are:

Revenue Act of 1918.

Sec. 402. That the value of the gross estate of the decedent shall be determined by including the value at the time of his death of all property, real or personal, tangible or intangible, wherever situated—

(a) To the extent of the interest therein of the decedent at the time of his death which after his death is subject to the payment of the charges against his estate and the expenses of its administration and is subject to distribution as part of his estate;

\* \* \* \* \*

(d) To the extent of the interest therein held jointly or as tenants in the entirety by the decedent and any other person, or deposited in banks or other institutions in their joint names and payable to either or the survivor, except such part thereof as may be shown to have originally belonged to such other person and never to have belonged to the decedent.

**290** Subdivisions (a) and (c) of Section 202 of the Revenue Act of 1916 are identical with subdivisions (a) and (d) of Section 402 of the Revenue Act of 1918, quoted above.

**291** While the community estate of husband and wife has not in the strictest sense all the incidents of a joint estate or an estate in the entirety as they were known at common law, I am convinced that the community estate is for all practical purposes within the language of subdivision (d) of Sec. 402, there being deductible therefrom, in arriving at the net estate of decedent, the one-half interest of the surviving spouse, which may be shown to have originally belonged to such person, and never to have belonged to the decedent.

**292** And even though it should be held that the community estate is not a "joint estate" or an "estate in the entirety" within the meaning of the revenue acts, the one-half interest of the deceased spouse in community property would still be subject to tax under the language of subdivision (a) above.

**293** My answers to your questions are therefore:

**294** (1) That in Washington, Arizona, Idaho, New Mexico, Louisiana and Nevada the husband and wife domiciled therein, in rendering separate income tax returns, may each report as gross income, one-half of the income which under the laws of the respective states becomes, simultaneously with its receipt, community property.

**295** (2) In the states mentioned in answer to question one there should be included in gross estate, in computing the estate tax of a deceased spouse, one-half only of the community property of husband and wife domiciled therein.

**296** (3) Neither of the above answers is based upon a statute enacted subsequent to March 1, 1913.

**297** (4) My answers to these questions apply under income and estate tax acts prior to the Revenue Act of 1918.

(Summary of opinion by Attorney General A. Mitchell Palmer, dated February 26, 1921, appended to and made a part of T. D. 3138, ¶265.)

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(Decision.)

Revenue Act of 1918.—Equally applicable to the 1921 Act.

June 20, 1922.

For the purposes of the deduction on account of charitable bequests, the amount of "bequests to charity" out of the residuary estate, is the amount of the residuary estate after state transfer or succession taxes have been paid therefrom by the terms of the will, without further reduction by the amount of the Federal Estate Tax on the net estate though such tax in fact does reduce by its amount the residuary estate passing to charity.

## UNITED STATES DISTRICT COURT:

## SOUTHERN DISTRICT OF NEW YORK.

JOSEPH FERMAIN SLOCUM, HERBERT JERMAIN SLOCUM, STEPHEN L'HOMMEDIU SLOCUM, ROBERT W. DEFOREST and HENRY W. DEFOREST, as executors of the Last Will and Testament of MARGARET OLIVIA SAGE,

*Plaintiffs,*

against

WILLIAM H. EDWARDS, formerly Collector of Internal Revenue for the Second District of New York,

*Defendant.*

**298** Augustus N. Hand, District Judge:—This is an action brought to  
**167** recover federal estate taxes alleged to have been erroneously assessed and collected. The gross estate amounted to . . . \$49,129,256.99

The funeral and administration expenses and debts amounted to . . . \$3,789,321.74

The bequests for charitable, religious, public and similar purposes, without any deduction for State taxes or estate succession taxes payable under Clause 6 of the will out of the residuary estate on bequests to individuals. . . . 36,721,855.70

Specific exemption. . . . 50,000.00

40,561,177.44

This left a net estate of . . . \$8,568,079.55 according to the return made by the estate upon which would be a total tax of \$1,406,977.50.

**299** The Commissioner of Internal Revenue revised this tax by deducting from the bequests for charitable purposes the amount of State transfer taxes, viz.: \$5,741.83 payable under Clause 6 of the will from the residuary estate which went to charity. He also deducted from the residuary estate going to charity the federal estate tax. This lessened the amount of the charitable bequests which are made deductible in computing the net estate subject to the estate tax and increased the tax accordingly. The sum of \$413,629.62 and interest is the amount of overpayment now sought to be recovered.

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**300** Section 203 of the Revenue Act of 1916 provides that for the purpose of the tax the value of the net estate shall be determined by deducting from the value of the gross estate funeral expenses, administration expenses, claims against the estate and "such other charges against the estate as are allowed by the laws of the jurisdiction whether within or without the United States under which the estate is administered."

**301** Section 403 (a) (3) of the Revenue Act of 1918 allows as a further deduction:

"(3) The amount of all bequests, legacies, devises or gifts to or for the use of the United States, any state, territory, any political subdivision thereof, or the District of Columbia, for exclusively public purposes or to or for the use of any corporation organized and operated exclusively for religious, charitable, scientific, literary or educational purposes, including the encouragement of art and the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any individual, or to a trustee or trustees exclusively for such religious, charitable, scientific, literary or educational purposes. This deduction shall be made in the case of all decedents who have died since December 31, 1917."

**302** The question for consideration is the meaning to be attached to the words: "The amount of all bequests, legacies, devises or gifts" when applied to a residuary gift to charity. This amount whatever it may be is what is to be deducted in finding the net estate upon which the tax is to be calculated. The charitable recipients of the testator's bounty ultimately receive only a balance constituted after the Government has taken out the estate tax levied as an excise tax upon the privilege granted to the testator of transmitting his property at death. In the case of an estate bequeathed to a single individual the estate tax might have been computed upon what he would receive after the estate had suffered diminution by the tax itself but such has never been the practice, and the uniform theory has been that the estate passing was to be treated without regard to the incidence of the tax itself. I see no reason why a different rule should be adopted in dealing with the words "The amount of all bequests, legacies, devises or gifts" even when applied to a residue to charity. In the first case if the taxes had been computed upon the amount actually passing after deducting the tax millions of dollars would have been saved to taxpayers. It does not seem consistent to look at the matter in a different way in dealing with the present case, particularly in view of the liberal legislation enacted in aid of charitable gifts.

**303** The State legacy tax amounting to \$5,741.83 payable out of the general estate under Clause 6 of the will would not, under the New York decisions be deductible from the residuary estate in appraising the value of that estate for the purpose of transfer taxes. *Matter of Swift*, 137 N. Y. 77.

**304** The Government in this case wishes to increase the net taxable estate by reducing the deductible residuary bequests to charity which have to pay this \$5,741.83 to the extent of that sum. In my opinion the decision of the New York Courts in construing the Transfer Tax Act should not control the present situation. If the New York Courts had reached any other decision than the one they did and had held that a direction to pay a tax upon a legacy to A out of the general estate lessened the general estate for purposes of taxation by the amount of the tax on A's legacy, the effect would have been to free the estate from any tax on the amount saved to A by the



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direction that the tax on his legacy should be paid from another fund. Such a result was unreasonable, and the New York Court properly held was not within any justifiable construction of the statute.

**305** In the present case, however, there is a direction under Clause 6 of the will that taxes on legacies to certain individuals should be paid out of the general estate. It may well be that this direction should not affect the amount or method of ascertaining any legacy tax, but where the deduction allowed for charitable bequests in computing the net taxable estate is limited to the amount of such bequests a specific charge by the terms of the will upon a portion of the estate bequeathed to charity alters the plain testamentary disposition of the testator's property to that extent and limits the amount of the charitable bequests pro tanto. It will be said that if the subtraction of the amount of all bequests to charity is to take into account legacy taxes payable out of such bequest by the terms of the will, it should take into account the Federal estate tax which is a legal charge upon the estate. I do not think the cases are parallel. The testator by her own direction limited the amount which the residuary legatees would receive by the legacy taxes. On the other hand, the uniform practice has been to disregard the Federal estate tax itself in determining the net estate. It is reasonable to apply the same rule in determining what is the residue which the testatrix gave to charity for the purpose of claiming the statutory deduction. Judge Rose in *Dugan v. Miles*, 276 Fed. 401, followed this rule.

**306** The motion for judgment dismissing the amended complaint is denied, and judgment is directed for the plaintiffs, with interest, except as to the tax on the sum of \$5,741.83, which sum should be deducted from the residue passing to charity and thus added to the net estate for purposes of taxation.

**307** The value of United States Bonds may not be excluded from the Gross or Net Estate in determining Estate Tax due.—The following opinion of the Solicitor of Internal Revenue, rendered February 13, 1917, is published for the information of all concerned:

Sir:

Answering the question presented by ——— under date of the 10th instant, relative to the liability of estates to taxation under the recent Federal Estate Tax Act, it is manifest from the following decisions of the U. S. Supreme Court that U. S. Government bonds must be added to the value of estates for the purpose of taxation under said Act.

The U. S. Supreme Court in *Plummer v. Coler*, (178 U. S. 134), considering the question whether, under the inheritance tax laws of a state, a tax might be validly imposed upon a legacy consisting of United States bonds issued under a statute declaring them exempt from state taxation in any form, said:

"We think the conclusion, fairly to be drawn from the state and Federal cases, is, that the right to take property by will or descent is derived from and regulated by municipal law; that, in assessing a tax upon such right or privilege, the State may lawfully measure or fix the amount of the tax by referring to the value of the property passing; and that the incidental fact that such property is composed wholly or in part of Federal securities, does not invalidate the tax or the law under which it is imposed."



## INDEXED SUPPLEMENTARY ESTATE TAX REGULATIONS, ETC.

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And dealing directly with the power of the Federal Government under the Inheritance Tax Act of 1898, to impose legacy taxes upon the transmission of an estate consisting of "free-tax" Government bonds, the Court in *Murdock v. Ward*, (178 U. S. 147), referring to the discussion and decision in the *Plummer* case, held:

"If a state inheritance law can validly impose a tax measured by the amount or value of the legacy, even if that amount includes United States bonds, the reasoning that justifies such a conclusion must, when applied to the case of a Federal inheritance law taxing the very same legacy, bring us to the same conclusion. We must therefore, hold that if, as held in *Knowlton v. Moore*, the tax imposed under the Act of June 13, 1898, is not invalid as a direct unapportioned tax, nor for want of uniformity, nor as an infringement upon the laws of the states regulating wills and descents, then the tax upon legacies or bequests, descendible under and regulated by state laws, is valid even if such legacies incidentally are composed of Federal bonds."

And further, in *Sherman v. United States* (178 U. S. 151), the Court said:

The proposition that bonds of the United States and the income therefrom are not lawfully taxable under an inheritance tax law of the United States, because exempted by contract from such tax has just been decided *not to be well founded*."

This is clearly conclusive of the whole question. (T. D. 2449, Feb. 13, 1917.) [For exception see ¶308 below.]

**308 U. S. Bonds owned by non-resident alien decedent.**—Please wire our expense whether United States bonds held in trust for non-resident alien individual but situated in United States are included in gross estate for purposes of estate tax. Has ruling published Corporation Trust Company War Tax Service nineteen twenty paragraph one-seventy-three, denying exemption, been modified? (Answer.) United States bonds situated in the United States owned by non-resident alien decedent form no part of gross estate of such decedent situated in the United States for purposes of federal estate tax. (Telegram of inquiry from Herrick, Smith, Donald & Farley, Boston, Mass., and the answer thereto signed by Deputy Commissioner James Hagerman, Jr., and dated Aug. 6, 1920.)

**309** [Letter supplementing the telegram above.] Referring to your letter dated May 26, 1920, relative to the taxability of bonds, notes and certificates of indebtedness of the United States and bonds of the War Finance Corporation owned by or held in trust for a nonresident alien at the time of his death, you are advised that bonds of the United States, beneficially owned by a nonresident alien, should not be included as a part of the gross estate in the United States for the purpose of the estate tax (Revenue Act of 1916, Sec. 202 (a); Revenue Act of 1918, Sec. 402 (a); Victory Liberty Loan Act, Act of March 3, 1919, Sec. 4 [¶310] amending Fourth Liberty Bond Act, Act of July 9, 1918, Sec. 3). This ruling is not in conflict with Treasury Decision No. 2530, and applies only to bonds enumerated in the above-mentioned Acts. (Letter to Herrick, Smith, Donald & Farley, Boston, Mass., signed by Deputy Commissioner James Hagerman, Jr., and dated August 21, 1920.)

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*Forward references to which are embodied in the foregoing Regulations 63.*

**310** Sec. 4 [of the Victory Liberty Loan Act].—That section 3 of the Fourth Liberty Bond Act is hereby amended to read as follows:

“Section 3. That, notwithstanding the provisions of the Second Liberty Bond Act or of the War Finance Corporation Act or of any other Act, bonds, notes, and certificates of indebtedness of the United States and bonds of the War Finance Corporation shall, while beneficially owned by a non-resident alien individual, or a foreign corporation, partnership, or association, not engaged in business in the United States, be exempt both as to principal and interest from any and all taxation now or hereafter imposed by the United States, any State, or any of the possessions of the United States or by any local taxing authority.” (Section 4 of “An Act to amend the Liberty Bond Acts and the War Finance Corporation Act, and for other purposes,” known as the “Victory Liberty Loan Act,” approved by the President, March 3, 1919.)

**311** Notice by others than duly qualified executor or administrator.—

**714** The subjoined extract from an opinion of the Solicitor of Internal Revenue dated September 23, 1916, is published for the information of those concerned.

“The said law, the Revenue Act of September 8, 1916, section 200, defines the term ‘executor’ as meaning, ‘the executor or administrator, of the decedent, or, if there is no executor or administrator any person who takes possession of any property of the decedent.’

“Section 205 requires ‘that the executor, within 30 days after qualifying as such, or after coming into possession of any property of the decedent, whichever event first occurs, shall give written notice thereof to the collector;’ and that ‘the executor shall also, at such times and in such manner as may be required by the regulations made under this title, file with the collector a return under oath in duplicate, setting forth the value of the gross estate,’ etc.

“Manifestly the purpose of the law is to secure such information and returns as will enable the Government to properly execute the law and collect such taxes as may be thereby imposed.

“In view of this uniform interpretation as to the requirement of notice and returns in all matters of revenue taxation, as well as the specific language of the law, I am of the opinion that you are justified in the preparation of regulations requiring persons who come into possession of the property of a decedent, or any part thereof, prior to the appointment of executors or administrators, to give due notice to the Collector of that fact. When executors or administrators are appointed, they, of course, supersede all other persons in the control of the property whether such persons are in possession or not, and the duty of giving notice and making returns for the entire estate immediately devolves upon such executors or administrators.” (T. D. 2372, Sept. 25, 1916.)

**312** Tax payment under 1918 Act may be enforced any time after expiration of one year period, in absence of extension, without regard to 180 day interest provision.—Reference is made to the memorandum dated June 19, 1920, transmitted by your Mr. Akers, who has re-



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quested to be advised whether the Bureau of Internal Revenue intends to require payment of Federal estate taxes within one year after the date of death of decedents whose estates are liable for the payment of such taxes.

**313** You are advised that the Bureau of Internal Revenue has ruled in specific cases, and it is its present ruling, that Federal estate taxes are due and payable one year after the death of a decedent whose estate is liable for the payment of such taxes. Section 406 of the Revenue Act of 1918 contemplates that the Federal estate tax shall be paid one year after decedent's death in every case except where the Commissioner of Internal Revenue finds that payment of the tax within one year after the decedent's death would impose undue hardship upon the estate and for that reason has granted an extension of time for the payment thereof. Article 90 of Regulations 37, Revised, 1919, relating to estate tax, requires payment of the tax at the expiration of one year from the date of the decedent's death.

**314** There is nothing contained in Section 408 of the Revenue Act of 1918 which fixes a different due date for the payment of the tax than that specifically set forth in Section 406 thereof, nor is there anything contained therein which prohibits the collection of the tax at any time after it is due. There is a provision in Section 408, which will not permit a collector in any case to withhold proceedings for the collection of the tax longer than one hundred and eighty days after it is due unless there be reasonable cause for the delay.

**315** In view of the foregoing, you are advised that payment of Federal estate taxes at the expiration of one year after the death of a decedent may be required in all cases except where the Commissioner finds that payment thereof within one year after decedent's death would impose undue hardship upon the estate. Payment of estate taxes, therefore, may not be withheld for a period of one year and one hundred and eighty days after decedent's death by those liable therefor. In all cases, however, no interest may be added to the tax unless one year and one hundred and eighty days have expired without payment having been made, except in a case where one year and ninety days since decedent's death had expired prior to February 25, 1919, and payment had not been made.

**316** There is returned herewith the memorandum which you transmitted to the Bureau. (Letter to The Corporation Trust Company, signed by Deputy Commissioner James Hagerman, Jr., and dated June 24, 1920.)

[See Court Decisions at ¶317 and ¶345.]



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*Forward references to which are embodied in the foregoing Regulations 63.**(Decision.)*

Revenue Act of 1918.

(281 Fed. 67.—T. D. 3325.)

The tax being due and payable one year after decedent's death, injunctive relief against its collection by distraint within the 180 day period thereafter will not be granted, there being ample remedy at law to redress any alleged injury consequent on enforced payment prior to the expiration of one year and 180 days.

UNITED STATES CIRCUIT COURT OF APPEALS  
FOR THE FIRST CIRCUIT.

MALCOLM E. NICHOLS, INDIVIDUALLY AND AS COLLECTOR OF  
INTERNAL REVENUE  
DEFENDANT, APPELLANT,

v.

WILLIAM A. GASTON ET AL., EXECUTORS,  
PLAINTIFFS, APPELLEES.

APPEAL FROM THE DISTRICT COURT OF THE UNITED STATES  
FOR THE DISTRICT OF MASSACHUSETTS.

**317** Bingham, J. This is an appeal from a final decree of the District  
**213** Court for Massachusetts in a suit in equity brought by Gaston and Falvey, executors of the estate of James M. Prendergast, against Nichols individually and as Collector of Internal Revenue for the District of Massachusetts, restraining the latter from collecting a tax assessed against the estate.

**318** The complainants and the defendant are citizens of Massachusetts. Prendergast died November 29, 1920. The complainants duly filed their return, setting forth the value of the estate, and the Commissioner of Internal Revenue assessed thereon a tax of \$83,900.36, under Title IV of the Revenue Act of February 24, 1919 (40 Stat. at Large, p. 1096). The jurisdiction of the District Court, as a Federal court, is invoked on the ground that the suit is one arising under the internal revenue laws of the United States.

**319** It is conceded that the tax of \$83,900.36 assessed against the estate is legal and proper. The contention of the complainants is that, under Section 408 of the Act of 1919, they are given a year and 180 days after their testator's death in which to pay the tax, even though the Commissioner of Internal Revenue had not extended the time of payment under Section 406 for 180 days after its due-date, and that the defendant was not authorized to enforce its collection by distraint or otherwise until after the expiration of the 180 days; that, in violation of this right, the defendant, pretending to act in his capacity as collector, on the 4th of January, 1922, and before the 180 days had expired, notified the complainants that, unless the tax was paid within ten days, he should proceed to collect the same, with costs, by seizure and sale of property; that, under Section 408 of the Act of 1919 the collector is prevented from collecting the tax by distraint or

otherwise within the 180 days; and that the threatened seizure, if carried out, would have been unauthorized and an act not done by him in his official capacity or with color of law. They further contend and allege in their bill that, if to avoid such threatened distraint, they at this time paid the tax, they would be remediless in law, as they had the privilege, under Section 406, of paying the tax at any time down to May 28, 1922, without interest. It was also alleged in the bill that the payment of the tax at the time of the commencement of the suit, rather than on May 28, 1922, would subject the estate to a loss of interest on the money during the interim of about three thousand dollars and would subject the estate to the difficulty of converting the assets into cash for the immediate payment of a large sum of money. But it appears in the final decree that it was stipulated in open court that the complainants had, at the time of the commencement of the suit and at the time of entering the decree, assets in their hands sufficient to meet the tax, and that the loss which they would have sustained by the payment would have been the interest on the tax, unless they were able to recover it back from the United States.

**320** The basis of the decree was that the payment of the tax was "not required by law or compellable by distraint until one year and 180 days after the death of" the decedent; that payment of the tax at the time of the filing of the bill instead of in May, 1922, "would have subjected the estate . . . to loss of interest on the money so paid during the interim, amounting to the sum of approximately \$3,000;" and that if, to avoid the threatened distraint, the complainants should "pay such tax prior to May 28, 1922, they would be remediless in the law."

**321** The questions sought to be raised are (1) whether, on the facts herein stated, the complainants are entitled to injunctive relief; and (2) whether, in view of Section 3224 of the Revised Statutes, which provides that "no suit for the purpose of restraining the assessment or collection of any tax shall be maintained in any court," this proceeding can be maintained.

**322** We think that there can be no doubt but that the District Court as a Federal court, had jurisdiction authorizing it to entertain the proceeding, as it involves a controversy arising under the laws of the United States; and that the broad questions are whether, on the admitted and agreed facts, that court, as a court of equity, was warranted in granting the injunction, especially in view of the provisions of Section 3224.

**323** It is a well recognized rule that a court of equity will not grant injunctive relief to complainants who have a remedy at law in the absence of a showing that the legal remedy is inadequate. If on the facts in this case the complainants would have had a remedy at law to redress their alleged injury, it cannot be contended that it would have been inadequate for the reason that the damages suffered would have been irreparable, as it appears that the only loss they would have sustained, had they paid the tax when demanded, would have been the loss of the use of the money during the balance of the 180 days, or in the vicinity of three thousand dollars.

**324** The question therefore is, so far as equity jurisdiction is concerned, whether the complainants would have been without a legal remedy provided they had paid the tax under protest at the time of its demand.

**325** Under Title XIII of the Revenue Law of 1919,—General Administrative Provisions—Section 1316 (a), it is provided:—

"Sec. 1316 (a) That Section 3220 of the Revised Statutes is hereby amended to read as follows:

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“Sec. 3220. The Commissioner of Internal Revenue, subject to regulations prescribed by the Secretary of the Treasury, is authorized to remit, refund, and pay back all taxes erroneously or illegally assessed or collected, all penalties collected without authority, and all taxes that appear to be unjustly assessed or excessive in amount, or in any manner wrongfully collected; also to repay to any collector or deputy collector the full amount of such sums of money as may be recovered against him in any court, for any internal revenue taxes collected by him, with the cost and expenses of suit; also all damages and costs recovered against any assessor, assistant assessor, collector, deputy collector, agent, or inspector, in any suit brought against him by reason of any thing done in the due performance of his official duty, and shall make report to Congress at the beginning of each regular session of Congress of all transactions under this section.”

**326** This provision of law was first enacted July 13, 1866 (14 Stat. at

Large, p. 111), and as above set forth is, so far as concerns the question here considered, the same as when first enacted. It thus appears from the language of the act that had the complainants paid the tax under protest at the time it was demanded, they could have recovered judgment against the collector for all damages they sustained, if the collection was premature and they were thereby damaged. *City of Philadelphia v. Collector*, 5 Wall. 720, 731 (decided Dec. 1866); *Moore v. Miller*, 5 Court of App. Dist. Col. 413, 429. And the following decisions disclose that they would have been entitled to interest on the damages sustained down to the entry of final judgment (*Schell v. Cochran*, 107 U. S. 625; *Kinney v. Conant*, 166 Fed. 720), and that, upon a certificate of probable cause by the court, under Section 989 of the Revised Statutes, the liability of the Government to pay the judgment would attach. *United States v. Sherman*, 98 U. S. 565; *Erschine v. Van Arsdale*, 15 Wall. 75; *National Volunteer Home v. Parrish*, 229 U. S. 494, 496; *Sage v. United States*, 250 U. S. 33, 37; *Smietanka v. Indiana Steel Co.* (decided October 24, 1921)—U. S.—. The fact that interest on the judgment, after it becomes final, as defined in *Schell v. Cochran*, *supra*, does not run against the Government (it being presumed that the Government is always ready and able to pay), has never been regarded as rendering the remedy at law inadequate.

**327** We are therefore of the opinion that the complainants have failed to show that they would have had no remedy at law. On the contrary, it would seem that they would have had a legal remedy by which they might have been reimbursed for all damages sustained, in case it should be found that the defendant was not authorized to demand and enforce the collection of the tax within the 180 days after it became due, and that the court below was without authority to grant the injunction, irrespective of the inhibition contained in Section 3224 of the Revised Statutes.

**328** In view of the conclusion reached, we do not feel called upon to decide whether Section 3224 imposes upon a court of equity any greater restraint as to enjoining the assessment and collection of a tax than it would properly be called upon to exercise had the statute not been enacted. The remedy at law is regarded as exclusive and, in the absence of extraordinary circumstances such as would warrant the interposition of a court of equity, has always been held to be exclusive.

**329** In *United States v. Pacific R. R.*, 4 Dill. 66, 70, Mr. Justice Miller, sitting as Circuit Justice for the Eastern District of Missouri, in speaking of the legal remedy afforded by Section 3220 of the Revised Statutes, said:



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"And we have said over and over again in our courts that that was a complete and exclusive system of correctional justice in regard to the collection of taxes unjustly assessed; that it was the only system, and by that ruling we abide. There can be no such thing as obstructing and objecting to the payment, as in the case of adjusting the accounts of individuals."

**330** It would seem, however, that the inhibition of Section 3224 applies to all assessments or collections of internal revenue taxes made or attempted to be made under color of office by internal revenue officers charged with general jurisdiction over the assessment and collection of such taxes, and that, if the Commissioner of Internal Revenue, in assessing a tax, or the collector, in collecting it, acts under color of his office, Section 3224 applies, and that no suit to restrain the assessment or collection of the tax can be maintained.

**331** In *Dodge v. Osborn*, 240 U. S. 118, Chief Justice White, in speaking of Sections 3220 and 3224, said:

"The plain purpose and scope of the sections are thus stated in *Snyder v. Marks*, 109 U. S. 189, 193-194, a suit brought to enjoin the collection of a revenue tax on tobacco:

"The inhibition of Rev. Stat., s. 3224, applies to all assessments of taxes, made under color of their offices, by internal revenue officers charged with general jurisdiction of the subject of assessing taxes against tobacco manufacturers. The remedy of a suit to recover back the tax after it is paid is provided by statute, and a suit to restrain its collection is forbidden. The remedy so given is exclusive, and no other remedy can be substituted for it. . . . *Cheatham v. United States*, 92 U. S. 85, 88; and again in *State Railroad Tax Cases*, 92 U. S. 575, 613, it was said by this court, that the system prescribed by the United States in regard to both customs duties and internal revenue taxes, of stringent measures, not judicial, to collect them, with appeals to specified tribunals, and suits to recover back moneys illegally exacted was a system of corrective justice intended to be complete, and enacted under the right belonging to the Government to prescribe the conditions on which it would subject itself to the judgment of the courts in the collection of its revenues. In the exercise of that right, it declares, by s. 3224, that its officers shall not be enjoined from collecting a tax claimed to have been unjustly assessed, when those officers, in the course of general jurisdiction over the subject-matter in question, have made the assignment (assessment) and claim that it is valid."

**332** In *Dodge v. Osborn*, it was held that it was "no longer open to question that a suit may not be brought to enjoin the assessment or collection of a tax because of the alleged unconstitutionality of the statute imposing it;" that averments that unless the tax were enjoined many suits by other persons would be brought for recovery of the taxes paid by them and that the taxes assessed would be a lien upon the plaintiff's property constituting a cloud thereon, were wholly inadequate to sustain jurisdiction; and that the statute plainly forbids the enjoining of a tax "unless by some extraordinary and entirely exceptional circumstance its provisions are not applicable."

**333** No question is raised in this case as to the authority of the Commissioner to assess the tax or as to the legality of the tax which he assessed. It is claimed, however, that the defendant, in undertaking to collect the tax, was acting without color of authority; that his acts were purely ministerial and in no way involved the exercise of discretion.

**334** By Section 1305, Title XIII of the Act of 1919, it is provided:

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"Sec. 1305. That all administrative, special or stamp provisions of law, including the law relating to the assessment of taxes, so far as applicable, are hereby extended to and made a part of this Act, and every person liable to any tax imposed by this Act, or for the collection thereof, shall keep such records and render, under oath, such statements and returns, and shall comply with such regulations as the Commissioner, with the approval of the Secretary, may from time to time prescribe."

**335** By Section 404—Title IV of the Act of 1919—it is provided:

"Sec. 404. . . . The Commissioner shall make all assessments of the tax under the authority of existing administrative, special and general provisions of law relating to the assessment and collection of taxes."

**336** By Section 3182 of the Revised Statutes it is provided:

"Sec. 3182. The Commissioner of Internal Revenue is hereby authorized and required to make the inquiries, determinations, and assessments of all taxes and penalties imposed by this Title, or accruing under any former internal-revenue act, where such taxes have not been duly paid by stamp at the time and in the manner provided by law, and shall certify a list of such assessments when made to the proper collectors respectively, who shall proceed to collect and account for the taxes and penalties so certified, etc."

**337** And Sections 3183, 3184 and 3187 provide:

"Sec. 3183. It shall be the duty of the collectors, or their deputies, in their respective districts, and they are authorized to collect all the taxes imposed by law, however the same may be designated, etc."

"Sec. 3184. Where it is not otherwise provided, the collector shall in person or by deputy, within ten days after receiving any list of taxes from the Commissioner of Internal Revenue, give notice to each person liable to pay any taxes stated therein, to be left at his dwelling or usual place of business, or to be sent by mail, stating the amount of such taxes and demanding payment thereof. If such person does not pay the taxes, within ten days after the service or the sending by mail of such notice, it shall be the duty of the collector or his deputy to collect the said taxes with a penalty of five per centum additional upon the amount of taxes, and interest at the rate of one per centum a month."

"Sec. 3187. If any person liable to pay any taxes neglects or refuses to pay the same within ten days after notice and demand, it shall be lawful for the collector or his deputy to collect the said taxes, with five per centum additional thereto, and interest as aforesaid, by distraint and sale, in the manner hereafter provided, of the goods, chattels, or effects, including stocks, securities, and evidences of debt, of the person delinquent as aforesaid, etc."

**338** By Section 1307,—Title XIII of the Act of 1919—it is provided:

"Sec. 1307. That in all cases where the method of collecting the tax imposed by this Act is not specifically provided in this Act, the tax shall be collected in such manner as the Commissioner, with the approval of the Secretary, may prescribe, etc."

**339** See Art. 116 of the Regulations for remedies prescribed for collection of tax.

**340** These provisions of law vested the Commissioner of Internal Revenue with authority to assess the tax in question and to certify the same in his list to the defendant for collection, whose duty it was to proceed and collect the tax in accordance with his precept. The Commissioner in issuing his list to the defendant for the collection of the tax necessarily determined that the tax was due and payable, that no postponement of the time of pay-



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ment had been granted, and that the defendant should proceed forthwith to collect it. It appears by Article 90 of the Rules and Regulations issued by the Commissioner, with the approval of the Secretary of the Treasury, construing Section 406, that the estate tax is due and payable one year from the date of death, and by Article 93 that the time of payment is to be extended only in case the Commissioner finds that payment of the tax one year from the date of death would impose undue hardship upon the estate. It cannot therefore be well claimed that the defendant, in proceeding under his precept and demanding payment of the tax, was not acting under color of authority or of his office, the Commissioner of Internal Revenue having, in the exercise of his general jurisdiction and with the approval of the Secretary of the Treasury, determined that the tax was due and payable at the end of one year from the death of the decedent and issued his list or precept for its collection. *Moore v. Miller, supra*, 430.

**341** If, under Section 406 and the Regulations, the tax is due and payable at the expiration of a year from death, where no postponement has been granted, then the provisions of Sections 406 and 408 are entirely consistent with one another and there is nothing in either section incompatible with action by the collector, upon receipt of the list, in forthwith demanding payment of the tax under Section 3184, and, if it is not paid, issuing a distraint warrant and enforcing collection by distraint under Section 3187.

**342** Indeed it is quite probable that the correct interpretation of Section 406 is that the tax is due and collectible one year after decedent's death, in the absence of a postponement of the time of collection for cause shown; that if no postponement from the due-date is procured, payment is demandable forthwith, with the right to invoke the usual remedies for its collection; that if a postponement is obtained for 180 days and the tax is paid on or before the expiration of that time, no interest charge is to be made; that, if the tax is not paid on or before the expiration of the postponed period of 180 days, then interest for the 180 days is to be added to the tax, and, under Section 408, the collector is thereupon to proceed to collect the tax and avail himself of the usual remedies, unless the time of payment is further delayed or extended by the Commissioner; that Section 408 by requiring the collector, if the tax has not been paid within the 180 days after it is due, to then proceed to collect it under the provisions of general law, etc., unless there is reasonable cause for further delay, recognizes there has been a previous delay in its collection and that it was for cause, the cause provided for in Section 406; and that Section 408 is not in conflict with Section 406 as to time of collection but supplementary thereto and in harmony therewith. We do not, however, find it necessary to construe the law.

**343** The only case called to our attention in which a court has granted an injunction restraining federal officials in the collection of a tax, since Section 3224 was enacted in 1867, is *Frayser & Co. v. Russell*, 3 Hughes, 227. But an examination of that case discloses that what the collector was asserting to be a tax was not a tax; that the collector had attempted to assess the tax himself, whereas, under Section 3371 of the Revised Statutes it was made the duty of the Commissioner of Internal Revenue to make the assessment and certify the same to the collector. As the Commissioner of Internal Revenue had not assessed the tax and certified it to the collector, the latter had neither a tax to collect nor color of authority for its collection.

**344** *The decree of the District Court is reversed, and the case is remanded to that court with directions to enter a decree of dismissal, with costs in this court and the court below to the appellant.*



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(Decision.)

(Revenue Act of 1918.)

(281 Fed. 74.—T. D. 3348.)

The tax being due and payable one year after decedent's death, injunctive relief against its collection by distraint within the 180 day period thereafter will not be granted, there being ample remedy at law to redress any alleged injury consequent on enforced payment prior to the expiration of one year and 180 days.

## UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIRST CIRCUIT.

Frank A. Page, Individually and as Collector of  
Internal Revenue,  
Defendant, Appellant,

v.

Frank L. Polk Et Al., Executors,  
Plaintiffs, Appellees.

Appeal from the District Court of the United States  
for the District of Rhode Island.

**345** BINGHAM, J.—This is an appeal from a final decree of the District  
**213** Court for Rhode Island in a suit in equity brought by Frank L. Polk and the United States Trust Company of New York, Executors of the Estate of Josephine Brooks, against Frank A. Page individually and as Collector of Internal Revenue for the District of Rhode Island, restraining the latter from collecting a tax assessed against the estate.

**346** The complainants are citizens of New York and the defendant is a citizen of Rhode Island. Josephine Brooks died August 17, 1920. The complainants duly filed their return setting forth the value of the estate, and the Commissioner of Internal Revenue assessed thereon a tax of \$245,787.67, under Title IV of the Revenue Act of February 24, 1919 (Stat. at Large, p. 1096). The jurisdiction of the District Court, as a federal court, is involved on the ground of diverse citizenship and that the amount involved exceeds five thousand dollars exclusive of interest and costs; also on the ground that the suit is one arising under the internal revenue laws of the United States.

**347** There is no controversy as to the legality or amount of the tax assessed against the estate. The complainants contend that under Section 408 of the Act of 1919, they are given a year and 180 days after their testatrix's death in which to pay the tax, even though the Commissioner of Internal Revenue had not extended the time of payment under Section 406 for 180 days after its due date, and that the defendant was not authorized to enforce its collection by distraint or otherwise until after the expiration of 180 days; that in violation of this right, the defendant, pretending to act in his capacity as collector, on the 28th day of September, 1921, and before the 180 days had expired, notified the complainants that, unless the tax was paid within ten days, he should proceed to collect the same, with costs, by seizure and sale of property; that under Section 408 of the Act of 1919 the collector is prevented from collecting the tax by distraint or otherwise within 180 days;

and that the threatened seizure, if carried out, would have been unauthorized and an act not done by him in his official capacity or with color of law. They further contend and allege in their bill that if, to avoid such threatened distraint, they at this time paid the tax, they would be remediless in law, as they had the privilege, under Section 406, of paying the tax at any time down to February 13, 1922, without interest. It was also alleged in the bill that the payment of the tax at the time of the commencement of the suit rather than on February 13, 1922, would subject the estate to loss of interest on the money during the interim in excess of five thousand dollars, and would subject the estate to the difficulty of converting the assets into cash for immediate payment of a large sum of money. But it appears in the final decree that it was stipulated in open court that the complainants had, at the time of the commencement of the suit and at the time of entering the decree, assets in their hands sufficient to meet the tax, and that the loss which they would have sustained by the payment would have been the interest on the tax, unless they were able to recover it back from the United States.

**348** It was decreed that the payment of the tax was "not required by law or compellable by distraint until one year and 180 days after the death of Josephine Brooks, which occurred on the seventeenth day of August, 1920"; that payment of the tax "at the time of the filing of the original bill herein, instead of in February, 1922 . . ., would have subjected the estate . . . to loss of interest on the money so paid during the interim amounting to a sum in excess of \$5,000; and that if, to avoid the threatened distraint, the plaintiffs should themselves pay such tax prior to February 13, 1922, they would be remediless in the law." It was further decreed that the defendant, his agents and servants, be permanently restrained "from making or attempting to make any seizure, distress or distraint of the property of the complainants . . . until the expiration of the thirteenth day of February, 1922 (but no longer)," and "that the complainants recover of the defendant, Frank A. Page individually, the sum of \$46.54, their costs and disbursements herein duly taxed."

**349** The bill of complaint was filed October 4, 1921. The final decree was entered December 27, 1921. A petition for appeal and assignment of errors was filed January 27, 1922, and on that day the appeal was allowed and citation issued returnable to this court February 24, 1922, the service of which was accepted January 27, 1922. The record was filed in this court February 9, 1922.

**350** On February 10, 1922, the 180 days having nearly elapsed, the complainants paid the Collector of Internal Revenue the tax in question.

When the case came on for hearing in this court the appellees (complainants) moved to affirm the decree or dismiss the appeal on the ground that, the tax having been paid, the questions presented by the appeal were academic. The appellant objected and now contends that the case should be considered on its merits and the decree reversed on the authority of our decision of March 21, 1922, in *Nichols v. Gaston et al., Executors* [¶317, herein]; that no other course can properly be taken as costs were awarded against him in the court below, which he has paid.

**351** Costs having been decreed against the appellant from which he would be relieved if the decree should be reversed, we think the case must be considered on its merits. *Matter of Application of Martin v. W. J. Johnston Co.*, 128 N. Y. 605.



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**352** The facts in this case, so far as they relate to the right of the appellees to restrain the appellant from collecting the tax, differ in no respect from those considered by us in *Nichols v. Gaston et al., Executors, supra*, in which it was held that the injunction was improperly issued. We see no occasion for receding from the views there expressed and are of the opinion that the appellees' motion should be denied, the decree of the District Court reversed, and costs awarded the appellant in this court and in the court below.

*The decree of the District Court is reversed and the case is remanded to that court with directions to enter a decree dismissing the bill, with costs to the appellant in this court and in the District Court.*

**353** United States bonds bearing interest at a higher rate than four per centum to be accepted at par and accrued interest in payment of estate tax.—Section 14 [6] of the Act of April 4, 1918 (Public—No. 120—65th Congress), provided in part:

"That any bonds of the United States bearing interest at a higher rate than four per centum (whether issued under section one of this Act or upon conversion of bonds issued under this Act or under said Act approved April twenty-fourth, nineteen hundred and seventeen), which have been owned by any person continuously for at least six months prior to the date of his death, and which upon such date constitute part of his estate, shall, under rules and regulations prescribed by the Secretary of the Treasury, be receivable by the United States at par and accrued interest in payment of any estate or inheritance taxes imposed by the United States, under or by virtue of any present or future law upon such estate or the inheritance thereof."

**354** Bonds of the United States falling within the classification specified will be accepted in payment of estate tax at par and accrued interest.

Bonds so receivable must (1) bear a higher rate of interest than four per centum per annum, and (2) have been owned by the decedent continuously for at least six months prior to the date of his death, and upon such date constitute a part of the estate of the decedent. The reckoning of the required period of ownership may begin on the date when the decedent acquired bonds bearing interest at a higher rate than four per centum, by purchase, by conversion of other bonds, or otherwise.

**355** The entire estate tax may be paid in bonds, or the tax may be paid partially in bonds and partially by cash or check. Collectors may not, however, accept bonds the par value and accrued interest on which aggregate a greater amount than the tax. (T. D. 2705, April 23, 1918.)

(Decision.—Act of April 4, 1918.)

(275 Fed. 814.)

### Receipt of Converted Liberty Bonds for Estate Taxes.

**356** 1. *Four per cent bonds converted—Computation of time.*—Where a decedent converted second Liberty 4% Bonds into third Liberty 4½% Bonds three weeks prior to his death, the latter bonds are not receivable for estate or inheritance taxes under the provisions of Section 14, Act of April 4, 1918 [¶353 herein] (40 Stat. 503, 505), as they were not held by him for at least six months prior to his death, and as the time that the



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four per cent bonds were held can not be tacked onto the period of holding the  $4\frac{1}{4}\%$  bonds.

**357** 2. *Constitutionality of Act.*—Section 14, so construed, does not work such unwarranted discrimination against that class of holders whose death occurred within the six months' period after the issue of the bonds, as to render unconstitutional so much of Section 14 as makes possible such result, as the classification is reasonable and proper, and treats all persons alike.

(The decision [syllabus only, as shown above] of the United States Circuit Court of Appeals for the Seventh Circuit, rendered at the April session, 1921, in the case of Julius S. Smietanka, Collector, v. Charlotte T. P. Ullman, reversing the decision of the District Court of the United States for the Northern District of Illinois, Eastern Division, is published not as a ruling of the Treasury Department, but for the information of Internal Revenue officers and others concerned.—T. D. 3227.)

### RECEIPT OF LIBERTY BONDS AND VICTORY NOTES FOR ESTATE OR INHERITANCE TAXES.

#### Department Circular No. 225.

**358** 1. The following regulations are prescribed pursuant to section 14 of the Second Liberty Bond Act, approved September 24, 1917, as amended by Third Liberty Bond Act, approved April 4, 1918, which section is as follows:

Sec. 14. That any bonds of the United States bearing interest at a higher rate than four per centum per annum (whether issued under section one of this Act or upon conversion of bonds issued under this Act or under said Act approved April twenty-fourth, nineteen hundred and seventeen), which have been owned by any person continuously for at least six months prior to the date of his death, and which upon such date constitute part of his estate, shall, under rules and regulations prescribed by the Secretary of the Treasury, be receivable by the United States at par and accrued interest in payment of any estate or inheritance taxes imposed by the United States, under or by virtue of any present or future law upon such estate or the inheritance thereof.

Pursuant to section 18(d) of the Second Liberty Bond Act, approved September 24, 1917, as amended by the Victory Liberty Loan Act, approved March 3, 1919, the word "bonds" where it appears in the above section shall be deemed to include notes issued under said section 18. This circular supercedes Treasury Department Circulars No. 132, dated January 30, 1919, and No. 151, dated June 24, 1919.

**359** 2. The bonds and notes coming within the provisions of said section at present issued and outstanding are—

Official title.	Date of issue.	Short title. <sup>1</sup>
(a) First Liberty Loan Converted $4\frac{1}{4}\%$ per cent bonds of 1932-47.	May 9, 1918	First $4\frac{1}{4}\%$ s.
(b) First Liberty Loan Second Converted $4\frac{1}{4}\%$ per cent bonds of 1932-47.	Oct. 24, 1918	First Second $4\frac{1}{4}\%$ s.
(c) Second Liberty Loan Converted $4\frac{1}{4}\%$ per cent bonds of 1927-42.	May 9, 1918	Second $4\frac{1}{4}\%$ s.
(d) Third Liberty Loan $4\frac{1}{4}\%$ per cent bonds of 1928.	May 9, 1918	Third $4\frac{1}{4}\%$ s.
(e) Fourth Liberty Loan $4\frac{1}{4}\%$ per cent bonds of 1933-38.	Oct. 24, 1918	Fourth $4\frac{1}{4}\%$ s.
(f) Victory Liberty Loan $4\frac{1}{4}\%$ per cent convertible gold notes of 1922-28.	May 20, 1919	Victory $4\frac{1}{4}\%$ s.

<sup>1</sup> Use short titles.

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**360** The words "bonds or notes" where they appear in this circular shall be deemed to refer, respectively, to the six issues of Liberty bonds and Victory notes above described. The First Liberty Loan  $3\frac{1}{2}$  per cent bonds of 1932-1947, the First Liberty Loan Converted 4 per cent bonds of 1932-1947, the Second Liberty Loan 4 per cent bonds of 1927-1942, and the  $3\frac{3}{4}$  per cent Victory Liberty Loan notes of 1922-23 are not acceptable in payment of Federal estate or inheritance taxes and are not "bonds or notes" within the meaning of these regulations.

**General Provisions.**

**361** 3. Bonds or notes of the issues above specified are receivable for such taxes only in case such bonds or notes have been owned by the decedent continuously for at least six months prior to the date of his death and upon such date constitute part of his estate. The reckoning of the required period of ownership will begin on the date when the decedent acquired such bonds or notes by original subscription, by purchase, by conversion of bonds or notes of other issues, or otherwise. For the purpose of reckoning the required period of ownership a fraction of a day shall be considered a whole day. In the case of acquisition of bonds or notes by original subscription, the date of original subscription, or the date of issue of the bonds or notes, whichever shall be later in time, shall be deemed to be the date of acquisition, provided that payment in full on the subscription shall have been completed and the bonds or notes delivered thereon. In the case of acquisition of bonds or notes by purchase, if registered bonds or notes of one of the issues above enumerated as acceptable in payment of Federal estate or inheritance taxes have been duly assigned in blank or for exchange or transfer, and delivered to the decedent assignee pursuant to such assignment, the date of such delivery will be deemed the date of acquisition, although such bonds or notes may not have been presented to the Treasury Department or to a Federal Reserve bank for transfer or exchange until a later date. In the case of acquisition of bonds or notes by conversion of bonds or notes of other issues previously owned, the date of presentation for conversion to the Treasury Department or a Federal Reserve bank will be deemed the date of acquisition: *Provided, however,* That (a)  $4\frac{1}{4}$  per cent bonds of the First Liberty Loan Converted and of the Second Liberty Loan Converted issued on conversion of 4 per cent bonds presented after July 1, 1918, and on or before November 9, 1918, pursuant to the provisions of Treasury Department Circular No. 114, dated May 9, 1918, shall, for the purpose of reckoning the required period of ownership, be deemed to have been acquired on June 15, 1918, in the case of bonds of the First Liberty Loan Converted, and on May 15, 1918, in the case of bonds of the Second Liberty Loan Converted; and (b) 4 per cent bonds of the First Liberty Loan Converted and of the Second Liberty Loan presented for conversion into  $4\frac{1}{4}$  per cent bonds on or after March 7, 1919, pursuant to the extension of the conversion privilege under Treasury Department Circular No. 137, as amended and supplemented, shall be deemed to be converted as of the interest payment date next succeeding the date of presentation for conversion, and such next succeeding interest payment date, and not the date of presentation for conversion, will be deemed to be the date of acquisition of such bonds for the purpose of reckoning the required period of ownership. Exchange of coupon for registered bonds or notes, or of registered for coupon bonds or notes, or of bonds or notes of one denomination for bonds or notes of



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other denominations of the same issue, or of temporary coupon bonds for permanent bonds, whether before or after the death of the decedent, will not prevent the receipt of the bonds or notes issued upon such exchange for estate or inheritance taxes, provided that no change of ownership takes place.

**362** 4. Bonds or notes tendered in payment of taxes pursuant to these regulations must be accompanied by an affidavit of one or more of the legal representatives of the estate on Form 760 Revised (Exhibit A), hereto attached, and the collector is authorized to require such further evidence as may be necessary to enable him to determine that the bonds or notes are properly receivable in payment of estate or inheritance taxes pursuant to law and these regulations. The term "legal representative" where it appears in this circular means the executor or administrator of the decedent's estate or, if there be no executor or administrator, such other person or persons as may be recognized as such under the Estate Tax Law and regulations and entitled to assign any registered bonds or notes owned by the decedent under the regulations of the Treasury Department with regard to United States bonds and notes.

**363** 5. On receipt of such bonds or notes, and on making such determination, and provided that the bonds or notes tendered conform to the other provisions of these regulations, the collector shall stamp or plainly write upon the face of each bond or note, over his signature, the following legend in indelible ink:

.....This bond/note has this day been received in  
(Date)  
payment of estate (or inheritance) taxes on the estate of.....  
(Name of decedent.)  
under authority of law, and will not be redeemed by the United  
States except for credit of the undersigned. ....,  
Collector of Internal Revenue for the..... District of.....

**364** Coupons, if any, attached to each bond or note, shall be indelibly stamped or marked "canceled" on the face of each coupon in letters of sufficient size to be plainly legible.

**365** 6. Where bonds or notes are owned by a partnership of which the decedent was a member for the six months prior to his death, and have been continuously so owned for at least the six months prior to his death, a fractional part of such bonds or notes proportionate to the deceased partner's share in the capital of the partnership will, for the purposes of these regulations, be deemed to have been owned by him to the extent that such fractional part is actually distributed to his estate upon liquidation: *Provided, however,* That nothing herein contained shall be deemed to make bonds or notes acceptable in amounts less than some authorized denomination thereof. In addition to the affidavit on Form 760 Revised, proof satisfactory to the Secretary of the Treasury must be presented as to the ownership of the bonds or notes by the partnership and the decedent's interest in the partnership; such proof in general should include affidavits of the surviving partners and of the legal representative of the decedent's estate showing (1) the character and extent of the interest of the decedent in the capital of the partnership, (2) any special interest of the decedent in the bonds or notes, (3) the period of ownership of the bonds or notes by the partnership and the period of the decedent's membership in the partnership, and (4) the distribution of the bonds or notes to the decedent's estate on account of his distributive share in the partnership.



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**366** 7. Where bonds or notes are held in trust for or otherwise beneficially owned by any person on terms which entitle him unconditionally to demand and receive the legal title or a divided share thereof at any time, he will, for the purposes of these regulations, be deemed the owner of such bonds or notes or such divided share thereof: *Provided, however,* That nothing herein contained shall be deemed to make bonds or notes acceptable in amounts less than some authorized denomination thereof. In addition to the affidavit on Form 760 Revised, proof satisfactory to the Secretary of the Treasury must be presented as to the ownership of the bonds or notes by the trust and the decedent's interest therein; such proof in general should include affidavits by the trustee and the legal representative of the decedent's estate showing (1) the creation of the trust, the terms and duration thereof, and the interest of the decedent therein; (2) the property included under the trust, and particularly the period of ownership of the bonds or notes by the trust; and (3) the distribution of the bonds or notes to the decedent's estate on account of his share in the trust estate, and the liability to Federal estate (or inheritance) tax in respect to such bonds or notes.

**367** 8. The entire tax may be paid in bonds or notes, or the tax may be paid partly in bonds or notes and partly by any other form of payment permitted by law or regulations duly in force. Collectors may not, however, receive bonds or notes the par value and accrued interest of which, computed in accordance with these regulations, aggregate a greater amount than the tax in payment of which the bonds or notes are tendered. After bonds or notes, or cash, have been tendered and duly received in payment of the tax, an election as to the method of payment will be deemed to have been made by the taxpayer, and thereafter requests for the return of such bonds or notes, or cash, and the acceptance of payment in the alternative form will be refused.

**Coupon Bonds or Notes.**

**368** 9. Coupon bonds or notes received for estate (or inheritance) taxes must be delivered to the collector with all unmatured coupons attached and with all matured coupons detached. Detached matured coupons will not be receivable in payment of such taxes. The portion of the face amount of the current coupon which represents accrued interest to date of receipt for taxes will be determined in the manner prescribed by the interest tables (Exhibits B and C) hereto attached, and such accrued interest will be receivable for estate or inheritance taxes.

**369** 10. Temporary coupon bonds, all coupons originally attached to which have matured and been detached, will not be accepted in payment of estate or inheritance taxes pursuant to the provisions of this circular, but must first be exchanged for permanent bonds, pursuant to the provisions of Treasury Department Circular No. 164, dated December 15, 1919, as amended and supplemented: *Provided, however,* That Fourth Liberty Loan  $4\frac{1}{4}$  per cent bonds of 1933-1938, in temporary form, will be acceptable until April 15, 1921, and First Liberty Loan Second Converted  $4\frac{1}{4}$  per cent bonds of 1932-1947, in temporary form, will be acceptable until June 15, 1921, in payment of such taxes, accrued interest on such bonds to date of receipt of taxes being covered for the current interest period by the temporary coupon bond; but after such dates, respectively, such temporary bonds must be exchanged for permanent bonds before presentation.

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*Forward references to which are embodied in the foregoing Regulations 63.*

**370** 11. Coupon bonds or notes, after being received, and reception indorsed on the bonds or notes as above required, will be deposited by the collector in the Federal Reserve Bank of the district in which his office is located (or Federal Reserve branch bank, as hereinafter provided) as a deposit of the par value with accrued interest, determined as above required. Such bonds or notes, unless delivered direct to the Federal Reserve bank or branch when located in the same city, must be transmitted by registered mail but will not be insured. The collector will transmit with the bonds or notes an accurate schedule on Form 761 Revised (Exhibit D) hereto attached, showing the serial number and denomination of each bond or note transmitted, the issue, the date of receipt for taxes, the amount of accrued interest, and the amount for which credited against estate or inheritance taxes. Such schedule shall be made in quadruplicate, the original to accompany the bonds or notes deposited with the Federal Reserve bank, the duplicate to be transmitted to such Federal Reserve bank under separate cover, the triplicate to be transmitted to the Secretary of the Treasury, Division of Loans and Currency, Washington, and the remaining copy to be retained by the collector. Collectors located in Federal Reserve bank branch cities will deposit coupon bonds or notes received by them hereunder with such branches in accordance with the provisions hereof, and the term "Federal Reserve bank," where it appears herein, includes such branches unless otherwise indicated by the context.

**371** 12. The Federal Reserve bank on receipt and examination of such bonds or notes will charge the Treasurer's account with par and accrued interest to date of receipt for taxes as reported by the collector, give credit in the Treasurer's account to the collector for like amount, and issue a certificate of deposit in triplicate on National Bank Form 15, transmitting the original to the Secretary of the Treasury through the Treasurer of the United States with its transcript, and the duplicate and triplicate to the collector, who will forward the duplicate to the Commissioner of Internal Revenue. Such Federal Reserve bank will then physically cancel the bonds or notes and coupons attached, and transmit the same to the Treasurer of the United States with the original or duplicate of the collector's schedule (Form 761 Revised), to which shall be added the Federal Reserve bank's certificate as shown thereon.

**372** 13. In the event that bonds or notes in coupon form are tendered to a collector of internal revenue in payment of Federal estate or inheritance taxes hereunder, and after having been received by the collector and stamped or otherwise indorsed by him as provided herein, are found to be not acceptable in payment of such taxes, Federal Reserve banks will issue clean bonds or notes in exchange for such erroneously stamped or indorsed coupon bonds or notes through the denominational exchange account: *Provided, however,* That the bonds or notes erroneously stamped or indorsed and presented for such exchange must be accompanied by an official certificate on Form 834 (Exhibit E) attached hereto, signed by the collector of internal revenue concerned, to the effect that the stamp or indorsement was affixed in error and that the bonds or notes (which must be specifically described) were not in fact accepted in payment of estate or inheritance taxes. Such exchanges need not be reported specifically to the Department, but the bonds or notes so stamped or indorsed and replaced must be accompanied by the certificate above described when forwarded by the Federal Reserve bank to the Department for credit. In case any



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such bonds or notes have been deposited with a Federal Reserve bank and charged to the Treasurer's account and credit therein given to the collector therefor, pursuant to paragraph 12 hereof, the Federal Reserve bank will issue new bonds or notes therefor as herein provided through its denominational exchange account, taking the receipt of the collector for such bonds or notes on Form N-2 (Exhibit G) attached hereto, and charging the collector in the Treasurer's account with the amount previously credited therein on account of such bonds or notes, supporting the entry with the receipt on Form N-2.

**Registered Bonds or Notes.**

**373** 14. Registered bonds or notes are also receivable for estate or inheritance taxes in accordance with these regulations. In addition to requiring the affidavit (Form 760 Revised) the collector shall determine that the registered owner whose name is inscribed on the bond or note is the decedent whose estate is liable to estate (or inheritance) taxes and that the bond or note is presented from the custody or control of the legal representative or representatives of such estate. Such bond or note shall be assigned to "the Secretary of the Treasury for redemption in payment of estate (or inheritance) taxes" by the authorized legal representative or representatives of the deceased registered owner. If an executor or administrator of the decedent's estate has been appointed, such representative or representatives must furnish to the collector a certificate under the seal of the court in which the estate is being administered or a duly certified copy of the letters testamentary or of administration, showing the appointment of such representative or representatives, the date thereof, and that the appointment is still in force. Such certificate or certification of the copy must be dated not more than thirty days prior to its presentation to the collector. All such documents of authority will be attached to the bond or note and forwarded therewith by the collector as hereinafter provided. where there are two or more legal representatives, all must unite in the assignment, unless by decree of court or testamentary provision some one or more of them is designated or empowered to dispose of the bonds or notes. If no executor or administrator has been appointed, the assignment must be made by the person or persons entitled to assign the bonds or notes under the regulations of the Treasury Department as to transfers without administration, and the bonds or notes will be accepted subject to submission to the Secretary of the Treasury, Division of Loans and Currency, for specific approval of the transfer. The form printed on the back of the bond or note must be used for assignment, and the assignment must be dated and properly acknowledged as prescribed in the note printed on the back of the bond or note. Officers authorized to take acknowledgements of assignments of registered bonds or notes in addition to those mentioned on the back of the bond are designated in paragraph 16 of Treasury Department Circular No. 141, dated September 15, 1919, and in the general regulations of the Treasury Department with regard to United States bonds and notes. The collector will satisfy himself that the above-mentioned documents of authority and the requisite signatures and acknowledgments are in hand before noting on the bond or note its reception for taxes, as provided in paragraph 5 hereof, but the final determination of the correctness or validity of the assignment will be made by the Secretary of the Treasury, Division of Loans and Currency, at Washington, on receipt of all such bonds or notes and documents, when transmitted as hereinafter provided.

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**374** 15. By reason of the periodical closing of the transfer books of the Treasury Department for the payment of interest on registered bonds and notes, and the impossibility of stopping payment of interest to the registered holder during the period of such closing, registered bonds and notes will not be receivable in payment of estate or inheritance taxes during the period of closing of the books of the issue in question unless an adjustment of interest is made with the collector as prescribed by paragraph 17 hereof. The books are closed with respect to each issue for one month prior to each interest date. The closed periods with respect to each bond or note may therefore be determined by inspection of the bond or note itself, being one month prior to each interest payment date named thereon, and until the day following such interest payment date. The closed periods for each issue of bonds or notes receivable for estate or inheritance taxes are also stated in the table (Exhibit H [¶386]) hereto attached.

**375** 16. Collectors will examine each registered bond or note tendered for estate or inheritance taxes to determine whether the transfer books of the issue in question are then opened or closed. If the books are then open but are due to close on a date too early to permit the bond or note to be transmitted to the Secretary of the Treasury, Division of Loans and Currency, and to be received by such division prior to the closing date, the collector will advise the Secretary of the Treasury, Division of Loans and Currency, by telegraph at the time of receipt of the bond or note, using form (Exhibit I) hereto attached, and will immediately confirm the same by mail. The Division of Loans and Currency will thereupon stop interest payment on such bond or note. The Secretary reserves the right to require an adjustment of the interest on any registered bond or note tendered to the collector during an open period but received at the Division of Loans and Currency during a closed period of the transfer books of the issue in question. Executors and other legal representatives are urged to tender registered bonds or notes at a time when the transfer books of such bonds or notes are open, or to exchange such bonds or notes for coupon bonds or notes before the transfer books of such bonds or notes close in order to avoid the necessity for interest adjustments.

**376** 17. Registered bonds or notes tendered pursuant to these regulations will be received at par and accrued interest computed in accordance with tables (Exhibits B and C), hereto attached. If such bonds or notes are tendered while the transfer books are open, the interest will be computed from the last preceding interest date as shown thereon to the date of receipt. If they are tendered while the transfer books are closed, since it is impossible to stop the mailing of the next interest check, they may be received at par, with a deduction for the interest from the date of receipt to such next following interest date, computed in accordance with said tables.

**377** 18. Registered bonds or notes received pursuant to these regulations, and bearing the stamp or writing required by paragraph 5 hereof, will be transmitted with all accompanying documents of authority to the Secretary of the Treasury, Division of Loans and Currency, Washington, by registered mail, but not insured. The collector will make an accurate schedule on Form 762 Revised (Exhibit J), hereto attached, in triplicate, showing the date of death of the decedent, the serial number and denomination of each bond or note, the issue, accrued interest, the date of receipt for taxes, and the amount for which credited against estate or inheritance taxes. The original of this schedule must accompany the bonds or notes

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sent to the Secretary of the Treasury, Division of Loans and Currency; the duplicate shall be transmitted to the Secretary of the Treasury, Division of Loans and Currency, under separate cover; and the triplicate shall be retained by the collector.

**378** 19. On receipt of such bonds or notes, the Division of Loans and Currency will determine whether the assignment is sufficient and has been properly executed, whether the bonds or notes are of an issue receivable for estate or inheritance taxes hereunder, whether the Department's record of registration is consistent with the affidavit of ownership (Form 760 Revised), and the amount at which such bonds or notes are receivable for estate or inheritance taxes, and will, if it finds the bonds or notes in order, transmit them with its advice on Form L. & C. 122 (Exhibit K), hereto attached, to the Treasurer of the United States for redemption. The Treasurer will thereupon cancel the bonds or notes and issue a certificate of deposit in the name of the collector, in triplicate, and will forward the original to the office of the Secretary of the Treasury, Division of Bookkeeping and Warrants, and transmit the duplicate and triplicate of such certificate to the Commissioner of Internal Revenue, Accounts Division, who will forward the triplicate to the collector.

**379** 20. In the event that bonds or notes in registered form are tendered to a collector of internal revenue in payment of Federal estate or inheritance taxes, pursuant hereto, and after having been assigned to the Secretary of the Treasury for redemption in payment of such taxes and received and stamped or otherwise indorsed by the collector as provided herein, are found to be not acceptable in payment of such taxes, the Secretary of the Treasury, or the Federal Reserve banks, will either (1) accept such registered bonds or notes for exchange for new registered bonds or notes registered in the same name, or (2) accept such registered bonds or notes, notwithstanding the assignment to the Secretary of the Treasury and the collector's stamp or indorsement thereon, for transfer or exchange pursuant to such subsequent assignments as may appear on such bonds or notes: *Provided, however*, in either case, that such registered bonds or notes are accompanied by an official certificate on Form 835 (Exhibit F), attached hereto, signed by the collector of internal revenue concerned, to the same effect as the certificate prescribed in paragraph 13 hereof, with reference to coupon bonds or notes. Registered bonds or notes so tendered in payment of Federal estate or inheritance taxes and erroneously assigned and stamped or indorsed must be forwarded by the Federal Reserve bank to the Treasury Department, Division of Loans and Currency, in regular course, and when forwarded must be accompanied by the official certificate of the collector.

**General.**

**380** 21. Until certificates of deposit are received by the collector, the amounts of bonds or notes deposited must be carried as "Cash on hand," and not credited as "Collections," as the dates of the certificates of deposit determine the dates of collections.

**381** 22. The Secretary of the Treasury may amend or withdraw the foregoing regulations in whole or in part at any time. (Department Circular No. 225, signed by D. F. Houston, Secretary of the Treasury, and dated January 31, 1921.)



### AFFIDAVIT OF OWNERSHIP OF BONDS/NOTES.

STATE OF.....County of.....ss:

[illegible]

..... (Signature.) ..... (Signature.)  
 ..... (Address for mail.) ..... (Address for mail.)

Notary Public, Deputy Collector.

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## 383 EXHIBIT B.

## LIBERTY LOAN

INTEREST TABLE FOR  $4\frac{1}{4}$  PER CENT BONDS.

Interest at \$100  $4\frac{1}{4}$  per cent per annum, payable semi-annually  $2\frac{1}{8}$  per cent per half year).

(Tables prepared by Government Actuary.)

NOTE.—Interest on United States bonds is computed on actual days basis within the interest period. For any given interest computation the appropriate column to be used may be determined from the following:

## NUMBER OF DAYS IN EACH HALF YEAR.

Half year ending the 15th day of—

Regular years—	Days.	Leap years—	Days.
March, May, July, August.....	181	March, May, July, August.....	182
April, June.....	182	April, June, October, December..	183
October, December.....	183	January, February, September,	
January February September		November.....	184
November.....	184		

Days.	Half year of 181 days.	Half year of 182 days.	Half year of 183 days.	Half year of 184 days.
1	\$0.01174033	\$0.01167582	\$0.01161202	\$0.01154891
2	.02348066	.02335165	.02322404	.02309783
3	.03522099	.03502747	.03483607	.03464674
4	.04696133	.04670330	.04644809	.04619565
5	.05870166	.05837912	.05806011	.05774457
6	.07044199	.07005495	.06967213	.06929348
7	.08218232	.08173077	.08128415	.08084239
8	.09392265	.09340659	.09289617	.09239130
9	.10566298	.10508242	.10450820	.10394022
10	.11740331	.11675824	.11612022	.11548913
11	.12914365	.12843407	.12773224	.12703804
12	.14088398	.14010989	.13934426	.13858696
13	.15262431	.15178571	.15095628	.15013587
14	.16436464	.16346154	.16256831	.16168478
15	.17610497	.17513736	.17418033	.17323370
16	.18784530	.18681319	.18579235	.18478261
17	.19958564	.19848901	.19740437	.19633152
18	.21132597	.21016484	.20901639	.20788043
19	.22306630	.22184066	.22062842	.21942935
20	.23480663	.23351648	.23224044	.23097826
21	.24654696	.24519231	.24385246	.24252717
22	.25828729	.25686813	.25546448	.25407609
23	.27002762	.26854396	.26707650	.26562500
24	.28176796	.28021978	.27868852	.27717391
25	.29350829	.29189560	.29030055	.28872283

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*Forward references to which are embodied in the foregoing Regulations 63.*

Days.	Half year of 181 days.	Half year of 182 days.	Half year of 183 days.	Half year of 184 days.
26	\$0.30524862	\$0.30357143	\$0.30191257	\$0.30027174
27	.31698895	.31524725	.31352459	.31182065
28	.32872928	.32692308	.32513661	.32336957
29	.34046961	.33859890	.33674863	.33491848
30	.35220994	.35027473	.34836066	.34646739
31	.36395028	.36195055	.35997268	.35801630
32	.37569061	.37362637	.37158470	.36956522
33	.38743094	.38530220	.38319672	.38111413
34	.39917127	.39697802	.39480874	.39266304
35	.41091160	.40865385	.40642077	.40421196
36	.42265193	.42032967	.41803279	.41576087
37	.43439227	.43200549	.42964481	.42730978
38	.44613260	.44368132	.44125683	.43885870
39	.45787293	.45535714	.45286885	.45040761
40	.46961326	.46703297	.46448087	.46195652
41	.48135359	.47870879	.47609290	.47350543
42	.49309392	.49038462	.48770492	.48505435
43	.50483425	.50206044	.49931694	.49660326
44	.51657459	.51373626	.51092896	.50815217
45	.52831492	.52541209	.52254098	.51970109
46	.54005525	.53708791	.53415301	.53125000
47	.55179558	.54876374	.54576503	.54279891
48	.56353591	.56043956	.55737705	.55434783
49	.57527624	.57211538	.56898907	.56589674
50	.58701657	.58379121	.58060109	.57744565
51	.59875691	.59546703	.59221311	.58899457
52	.61049724	.60714286	.60382514	.60054348
53	.62223757	.61881868	.61543716	.61209239
54	.63397790	.63049451	.62704918	.62364130
55	.64571823	.64217033	.63866120	.63519022
56	.65745856	.65384615	.65027322	.64673913
57	.66919890	.66552198	.66188525	.65828804
58	.68093923	.67719780	.67349727	.66983696
59	.69267956	.68887363	.68510929	.68138587
60	.70441989	.70054945	.69672131	.69293478
61	.71616022	.71222527	.70833333	.70448370
62	.72790055	.72390110	.71994536	.71603261
63	.73964088	.73557692	.73155738	.72758152
64	.75138122	.74725275	.74316940	.73913043
65	.76312155	.75892857	.75478142	.75067935
66	.77486188	.77060440	.76639344	.76222826
67	.78660221	.78228022	.77800546	.77377717
68	.79834254	.79395604	.78961749	.78532609
69	.81008287	.80563187	.80122951	.79687500
70	.82182320	.81730769	.81284153	.80842391
71	.83356354	.82898352	.82445355	.81997283
72	.84530387	.84065934	.83606557	.83152174
73	.85704420	.85233516	.84767760	.84307065
74	.86878453	.86401099	.85928962	.85461957
75	.88052486	.87568681	.87090164	.86616848
76	.89226519	.88736264	.88251366	.87771739
77	.90400552	.89903846	.89412568	.88926630
78	.91574586	.91071429	.90573770	.90081522
79	.92748619	.92239011	.91734973	.91236413
80	.93922652	.93406593	.92896175	.92391304

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*Forward references to which are embodied in the foregoing Regulations 63.*

Days.	Half year of 181 days.	Half year of 182 days.	Half year of 183 days.	Half year of 184 days.
81	\$0.95096685	\$0.94574176	\$0.94057377	\$0.93546196
82	.96270718	.95741758	.95218579	.94701087
83	.97444751	.96909341	.96379781	.95855978
84	.98618785	.98076923	.97540984	.97010870
85	.99792818	.99244505	.98702186	.98165761
86	1.00966851	1.00412088	.99863388	.99320652
87	1.02140884	1.01579670	1.01024590	1.00475543
88	1.03314917	1.02747253	1.02185792	1.01630435
89	1.04488950	1.03914835	1.03346995	1.02785326
90	1.05662983	1.05082418	1.04508197	1.03940217
91	1.06837017	1.06250000	1.05669399	1.05095109
92	1.08011050	1.07417582	1.06830601	1.06250000
93	1.09185083	1.08585165	1.07991803	1.07404891
94	1.10359116	1.09752747	1.09153005	1.08559783
95	1.11533149	1.10920330	1.10314208	1.09714674
96	1.12707182	1.12087912	1.11475410	1.10869565
97	1.13881215	1.13255495	1.12636612	1.12024457
98	1.15055249	1.14423077	1.13797814	1.13179348
99	1.16229282	1.15590659	1.14959016	1.14334239
100	1.17403315	1.16758242	1.16120219	1.15489130
101	1.18577348	1.17925824	1.17281421	1.16644022
102	1.19751381	1.19093407	1.18442623	1.17798913
103	1.20925414	1.20260989	1.19603825	1.18953804
104	1.22099448	1.21428571	1.20765027	1.20108696
105	1.23273481	1.22596154	1.21926230	1.21263587
106	1.24447514	1.23763736	1.23087432	1.22418478
107	1.25621547	1.24931319	1.24248634	1.23573370
108	1.26795580	1.26098901	1.25409836	1.24728261
109	1.27969613	1.27266484	1.26571038	1.25883152
110	1.29143646	1.28434066	1.27732240	1.27038043
111	1.30317680	1.29601648	1.28893443	1.28192935
112	1.31491713	1.30769231	1.30054645	1.29347826
113	1.32665746	1.31936813	1.31215847	1.30502717
114	1.33839779	1.33104396	1.32377049	1.31657609
115	1.35013812	1.34271978	1.33538251	1.32812500
116	1.36187845	1.35439560	1.34699454	1.33967391
117	1.37361878	1.36607143	1.35860656	1.35122283
118	1.38535912	1.37774725	1.37021858	1.36277174
119	1.39709945	1.38942308	1.38183060	1.37432065
120	1.40883978	1.40109890	1.39344262	1.38586957
121	1.42058011	1.41277473	1.40505464	1.39741848
122	1.43232044	1.42445055	1.41666667	1.40896739
123	1.44406077	1.43612637	1.42827869	1.42051630
124	1.45580110	1.44780220	1.43989071	1.43206522
125	1.46754144	1.45947802	1.45150273	1.44361413
126	1.47928177	1.47115385	1.46311475	1.45516304
127	1.49102210	1.48282967	1.47472678	1.46671196
128	1.50276243	1.49450549	1.48633880	1.47826087
129	1.51450276	1.50618132	1.49795082	1.48980978
130	1.52624309	1.51785714	1.50956284	1.50135870
131	1.53798343	1.52953297	1.52117486	1.51290761
132	1.54972376	1.54120879	1.53278689	1.52445652
133	1.56146409	1.55288462	1.54439891	1.53600543
134	1.57320442	1.56456044	1.55601093	1.54755435
135	1.58494475	1.57623626	1.56762295	1.55910326

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Days	Half year of 181 days.	Half year of 182 days.	Half year of 183 days.	Half year of 184 days.
136	\$1.59668508	\$1.58791209	\$1.57923497	\$1.57065217
137	1.60842541	1.59958791	1.59084699	1.58220109
138	1.62016575	1.61126374	1.60245902	1.59375000
139	1.63190608	1.62293956	1.61407104	1.60529891
140	1.64364641	1.63461538	1.62568306	1.61684783
141	1.65538674	1.64629121	1.63729508	1.62839674
142	1.66712707	1.65796703	1.64890710	1.63994565
143	1.67886740	1.66964286	1.66051913	1.65149457
144	1.69060773	1.68131868	1.67213115	1.66304348
145	1.70234807	1.69299451	1.68374317	1.67459239
146	1.71408840	1.70467033	1.69535519	1.68614130
147	1.72582873	1.71634615	1.70696721	1.69769022
148	1.73756906	1.72802198	1.71857924	1.70923913
149	1.74930939	1.73969780	1.73019126	1.72078804
150	1.76104972	1.75137363	1.74180328	1.73233696
151	1.77279006	1.76304945	1.75341530	1.74388587
152	1.78453039	1.77472527	1.76502732	1.75543478
153	1.79627072	1.78640110	1.77663934	1.76698370
154	1.80801105	1.79807692	1.78825137	1.77853261
155	1.81975138	1.80975275	1.79986339	1.79008152
156	1.83149171	1.82142857	1.81147541	1.80163043
157	1.84323204	1.83310440	1.82308743	1.81317935
158	1.85497238	1.84478022	1.83469945	1.82472826
159	1.86671271	1.85645604	1.84631148	1.83627717
160	1.87845304	1.86813187	1.85792350	1.84782609
161	1.89019337	1.87980769	1.86953552	1.85937500
162	1.90193370	1.89148352	1.88114754	1.87092391
163	1.91367403	1.90315934	1.89275956	1.88247283
164	1.92541436	1.91483517	1.90437158	1.89402174
165	1.93715470	1.92651099	1.91598361	1.90557065
166	1.94889503	1.93818681	1.92759563	1.91711957
167	1.96063536	1.94986264	1.93920765	1.92866848
168	1.97237569	1.96153846	1.95081967	1.94021739
169	1.98411602	1.97321429	1.96243169	1.95176630
170	1.99585335	1.98489011	1.97404372	1.96331522
171	2.00759669	1.99656593	1.98565574	1.97486413
172	2.01933702	2.00824176	1.99726776	1.98641304
173	2.03107735	2.01991758	2.00887978	1.99796196
174	2.04281768	2.03159341	2.02049180	2.00951087
175	2.05455801	2.04326923	2.03210383	2.02105978
176	2.06629834	2.05494505	2.04371585	2.03260870
177	2.07803867	2.06662088	2.05532787	2.04415761
178	2.08977901	2.07829670	2.06693989	2.05570652
179	2.10151934	2.08997253	2.0785 191	2.06725543
180	2.11325967	2.10164835	2.09016393	2.07880435
181	2.12500000	2.11332418	2.10177596	2.09035326
182	.....	2.12500000	2.11338798	2.10190217
183	.....	.....	2.12500000	2.11345109
184	.....	.....	.....	2.12500000

## INDEXED SUPPLEMENTARY ESTATE TAX REGULATIONS, ETC.

*Forward references to which are embodied in the foregoing Regulations 63.**Example.***384** \$10,850 Third 4 $\frac{1}{4}$ s tendered in payment of estate taxes January 5, 1921.Interest payment dates on Third 4 $\frac{1}{4}$ s are shown on the face thereof to be March 15 and September 15 in each year.

Current half year interest period therefore ends March 15, 1921.

The year 1921 being a "regular" (not a "leap") year, find "March" in the list at head of table under "Regular years." This list shows that the half year ending March 15 in a regular year has 181 days.

Compute number of days since the beginning of such half year that have expired to date of tender of bonds, thus:

1920.	Days.
Sept. 15 to Sept. 30.....	15
October.....	31
November.....	30
December.....	31
1921.	
January.....	5
Total.....	112

Enter table headed "Half year of 181 days" (second column) and seek in that column the amount of interest on \$100 for 112 days. This will be found opposite the figure "112" (days) in first column, and proves to be \$1.31491713, which is the decimal for \$100 for 112 days.

The amount of bonds presented being \$10,850, the decimal above stated must be multiplied by 108.5; the result is \$142.6685, which is the amount of accrued interest due on January 5, 1921, on \$10,850 Third 4 $\frac{1}{4}$ s; accordingly the bonds are worth for estate taxes \$10,992.67.Fractions of cents if less than  $\frac{1}{2}$  cent, will be disregarded; if  $\frac{1}{2}$  cent or more, will be counted as 1 cent.**Exhibit C.****385****VICTORY LIBERTY LOAN****Form L. & C. 226.****Interest Table for 4 $\frac{3}{4}$ % Per Cent Victory Notes Received for Estate or Inheritance Taxes.****(Prepared by Government actuary)****Note.**—Interest on Victory notes is computed on actual day's basis within the interest period. For any given interest computation, the appropriate column to be used may be determined from the following.**Number of Days in Each Half Year****Half year ending the 15th day of.....**

Regular years	Days	Leap years	Days
June.....	182	June.....	183
December.....	183	December.....	183



## INDEXED SUPPLEMENTARY ESTATE TAX REGULATIONS, ETC.

*Forward references to which are embodied in the foregoing Regulations 63.*

*Interest on \$100 at  $4\frac{3}{4}$  per cent per annum, payable semi-annually  
( $2\frac{3}{8}$  per cent per half year).*

Days	Half year of 182 days	Half year of 183 days	Days	Half year of 182 days	Half year of 183 days
1	\$0.0130495	\$0.0129781	51	\$.6655220	\$.6618852
2	.0260989	.0259563	52	.6785714	.6748634
3	.0391484	.0389344	53	.6916209	.6878415
4	.0521978	.0519126	54	.7046703	.7008197
5	.0652473	.0648907	55	.7177198	.7137978
6	.0782967	.0778689	56	.7307692	.7267760
7	.0913462	.0908470	57	.7438187	.7397541
8	.1043956	.1038251	58	.7568681	.7527322
9	.1174451	.1168033	59	.7699176	.7657104
10	.1304945	.1297814	60	.7829670	.7786885
11	.1435440	.1427596	61	.7960165	.7916667
12	.1565934	.1557377	62	.8090659	.8046448
13	.1696429	.1687158	63	.8221154	.8176230
14	.1826923	.1816940	64	.8351648	.8306011
15	.1957418	.1946721	65	.8482143	.8435792
16	.2087912	.2076503	66	.8612637	.8565574
17	.2218407	.2206284	67	.8743132	.8695355
18	.2348901	.2336066	68	.8873626	.8825137
19	.2479396	.2465847	69	.9004121	.8954918
20	.2609890	.2595628	70	.9134615	.9084699
21	.2740385	.2725410	71	.9265110	.9214481
22	.2870879	.2855191	72	.9395604	.9344262
23	.3001374	.2984973	73	.9526099	.9474044
24	.3131868	.3114754	74	.9656593	.9603825
25	.3262363	.3244536	75	.9787088	.9733607
26	.3392857	.3374317	76	.9917582	.9863388
27	.3523352	.3504098	77	1.0048077	.9993169
28	.3653846	.3633880	78	1.0178571	1.0122951
29	.3784341	.3763661	79	1.0309066	1.0252732
30	.3914835	.3893443	80	1.0439560	1.0382514
31	.4045330	.4023224	81	1.0570055	1.0512295
32	.4175824	.4153005	82	1.0700549	1.0642077
33	.4306319	.4282787	83	1.0831044	1.0771858
34	.4436813	.4412568	84	1.0961538	1.0901639
35	.4567308	.4542350	85	1.1092033	1.1031421
36	.4697802	.4672131	86	1.1222527	1.1161202
37	.4828297	.4801913	87	1.1353022	1.1290984
38	.4958791	.4931694	88	1.1483516	1.1420765
39	.5089286	.5061475	89	1.1614011	1.1550546
40	.5219780	.5191257	90	1.1744505	1.1680328
41	.5350275	.5321038	91	1.1875000	1.1810109
42	.5480769	.5450820	92	1.2005495	1.1939891
43	.5611264	.5580601	93	1.2135989	1.2069672
44	.5741758	.5710383	94	1.2266484	1.2199454
45	.5872253	.5840164	95	1.2396978	1.2329235
46	.6002747	.5969945	96	1.2527473	1.2459016
47	.6133242	.6099727	97	1.2657967	1.2588798
48	.6263736	.6229508	98	1.2788462	1.2718579
49	.6394231	.6359290			
50	.6524725	.6489071			



## INDEXED SUPPLEMENTARY ESTATE TAX REGULATIONS, ETC.

*Forward references to which are embodied in the foregoing Regulations '63.*

99	\$1.2918956	\$1.2848361	141	\$1.8399725	\$1.8299180
100	1.3049451	1.2978142	142	1.8530220	1.8428962
			143	1.8660714	1.8558743
101	1.3179945	1.3107923	144	1.8791209	1.8688525
102	1.3310440	1.3237705	145	1.8921703	1.8818306
103	1.3440934	1.3367486			
104	1.3571429	1.3497268	146	1.9052198	1.8948087
105	1.3701923	1.3627049	147	1.9182692	1.9077869
			148	1.9313187	1.9207650
106	1.3832418	1.3756831	149	1.9443681	1.9337432
107	1.3962912	1.3886612	150	1.9574176	1.9467213
108	1.4093407	1.4016393			
109	1.4223901	1.4146175	151	1.9704670	1.9596995
110	1.4354396	1.4275956	152	1.9835165	1.9726776
			153	1.9965659	1.9856557
111	1.4484890	1.4405738	154	2.0096154	1.9986339
112	1.4615385	1.4535519	155	2.0226648	2.0116120
113	1.4745879	1.4665301			
114	1.4876374	1.4795082	156	2.0357143	2.0245902
115	1.5006868	1.4924863	157	2.0487637	2.0375683
			158	2.0618132	2.0505464
116	1.5137363	1.5054645	159	2.0748626	2.0635246
117	1.5267857	1.5184426	160	2.0879121	2.0765027
118	1.5398352	1.5314208			
119	1.5528846	1.5443985	161	2.1009615	2.0894809
120	1.5659341	1.5573770	162	2.1140110	2.1024590
			163	2.1270604	2.1154372
121	1.5789835	1.5703552	164	2.1401099	2.1284153
122	1.5920330	1.5833333	165	2.1531593	2.1413934
123	1.6050824	1.5963115			
124	1.6181319	1.6092896	166	2.1662088	2.1543716
125	1.6311813	1.6222678	167	2.1792582	2.1673497
			168	2.1923077	2.1803279
126	1.6442308	1.6352459	169	2.2053571	2.1933060
127	1.6572802	1.6482240	170	2.2184066	2.2062842
128	1.6703297	1.6612022			
129	1.6833791	1.6741803	171	2.2314560	2.2192623
130	1.6964286	1.6871585	172	2.2445055	2.2322404
			173	2.2575549	2.2452186
131	1.7094780	1.7001366	174	2.2706044	2.2581967
132	1.7225275	1.7131148	175	2.2836538	2.2711749
133	1.7355769	1.7260929			
134	1.7486264	1.7390710	176	2.2967033	2.2841530
135	1.7616758	1.7520492	177	2.3097527	2.2971311
			178	2.3228022	2.3101093
136	1.7747253	1.7650273	179	2.3358516	2.3230874
137	1.7877747	1.7780055	180	2.3489011	2.3360656
138	1.8008242	1.7909836			
139	1.8138736	1.8039617	181	2.3619505	2.3490437
140	1.8269231	1.8169399	182	2.3750000	2.3620219
			183	.....	2.3750000

*Example.*

\$11,350  $4\frac{3}{4}$  per cent Victory notes tendered in payment of estate taxes, January 5, 1921.

Interest payment dates on Victory notes are shown on the face thereof to be June 15 and December 15 in each year, and at maturity.

Current half-year interest period therefore ends June 15, 1921.

The year 1921 being a regular year, find "June" in the list at head of table under "Regular year." This list shows that the half year ending June 15, in a regular year, has 182 days.

## INDEXED SUPPLEMENTARY ESTATE TAX REGULATIONS, ETC.

Forward references to which are embodied in the foregoing Regulations 63.

Compute number of days since the beginning of such half year that have expired to date of tender of note, thus:

	Days.
1920.	
December 15 to December 31.....	16
1921.	
January.....	5
Total.....	21

Enter table headed "Half year of 182 days" (second column) and seek in that column the amount of interest on \$100 for 21 days. This will be found opposite the figure "21" (days) in the first column, and proves to be \$0.2740385, which is the decimal for \$100 for 21 days.

The amount of notes presented being \$11,350, the decimal above stated must be multiplied by 113.5; the result is \$31.1034, which is the amount of accrued interest due on January 5, 1921, on \$11,350 Victory 4 $\frac{3}{4}$ s—accordingly, the notes are worth for estate taxes, \$11,381.10.

Fractions of cents, if less than  $\frac{1}{2}$  cent, will be disregarded; if  $\frac{1}{2}$  cent or more, will be counted as 1 cent.

## Exhibit H.

### 386 Periods During Which Transfer Books are Closed for the Various Issues of Liberty Bonds and Victory Notes Receivable for Estate or Inheritance Taxes.

Title of bonds, notes.	Short title.	Closed periods.	
		From close of business.	To opening of business.
First Liberty Loan converted 4 $\frac{1}{4}$ per cent bonds of 1932-47....	First 4 $\frac{1}{4}$ 's	May 15	June 16
First Liberty Loan second converted 4 $\frac{1}{4}$ per cent bonds of 1932-47.....	First Second 4 $\frac{1}{4}$ 's	Nov. 15	Dec. 16
Second Liberty Loan converted 4 $\frac{1}{4}$ per cent bonds of 1927-42...	Second 4 $\frac{1}{4}$ 's	Apr. 15	May 16
Third Liberty Loan 4 $\frac{1}{4}$ per cent bonds of 1928.....	Third 4 $\frac{1}{4}$ 's	Oct. 15	Nov. 16
		Feb. 15	Mar. 16
		Aug. 15	Sept. 16
Fourth Liberty Loan 4 $\frac{1}{4}$ per cent bonds of 1933-38.....	Fourth 4 $\frac{1}{4}$ 's	Mar. 15	Apr. 16
		Sept. 15	Oct. 16
		May 15	June 16
		Nov. 15	Dec. 16
Victory Liberty Loan 4 $\frac{3}{4}$ per cent convertible gold notes of 1922-23.....	Victory 4 $\frac{3}{4}$ 's	and from close of business Apr. 20, 1923.	

NOTE.—If the closing date falls on a Sunday or a legal holiday the transfer books will close on the preceding day; if the opening date falls on Sunday or legal holiday the books will open on the following day.

(Exhibits A, B, C, and H, above, from Department Circular No. 225, signed by D. F. Houston, Secretary of the Treasury, and dated January 31, 1921.)



## INDEXED SUPPLEMENTARY ESTATE TAX REGULATIONS, ETC.

*Forward references to which are embodied in the foregoing Regulations 63.*

(T. D. 3144.)

**387** Receipt of Liberty bonds or Victory notes for estate and inheritance taxes.—The appended [foregoing] Department circular No. 225 [beginning at ¶356], issued under date of January 31, 1921, with reference to receipt of Liberty bonds and Victory notes in payment of estate and inheritance taxes, is published for the information of internal-revenue officers and others concerned. This circular supersedes Department circulars No. 132, dated January 30, 1919 (T. D. 2802), and No. 151, dated June 24, 1919 (T. D. 2905). (T. D. 3144, signed by Acting Commissioner Paul F. Myers, and dated March 3, 1921.)

**388** Receipt of Liberty Bonds, Victory Notes, and Treasury Notes for  
216 Estate or Inheritance Taxes.—The appended [¶389] department circular, issued under date of June 30, 1922, with reference to receipt of Treasury notes of the United States in payment of Federal estate and inheritance taxes, is published for the information of internal-revenue officers and others concerned. This circular supplements Department Circular No. 225, dated January 31, 1921 (T. D. 3144) [¶387]. (T. D. 3383, signed by Commissioner D. H. Blair, and dated August 9, 1922.)

**389** 1. The provisions of Department Circular No. 225, dated January 31, 1921, prescribing regulations governing the receipt of Liberty bonds and Victory notes for Federal estate or inheritance taxes are hereby extended and made applicable to Treasury notes of the United States now or hereafter issued under authority of Section 18 of the Second Liberty Bond Act, as amended and supplemented, bearing interest at a higher rate than 4 per centum per annum, and any such Treasury notes shall accordingly be receivable by the United States at par and accrued interest in payment of any estate or inheritance taxes imposed by the United States, under or by virtue of any present or future law, upon the same terms and conditions as provided in said Department Circular No. 225, dated January 31, 1921, with respect to the acceptance of Liberty bonds and Victory notes bearing interest at a higher rate than 4 per centum per annum.

**390** 2. The issues of Treasury notes at this date outstanding, bearing interest at a higher rate than 4 per centum per annum, are:

Description	Date of Issue	Short Title
(a) 5½ per cent notes, payable June 15, 1924.....	June 15, 1921	Series A-1924
(b) 5½ per cent notes, payable Sept. 15, 1924.....	Sept. 15, 1921	Series B-1924
(c) 4¾ per cent notes, payable Mar. 15, 1925.....	Feb. 1, 1922	Series A-1925
(d) 4¾ per cent notes, payable Mar. 15, 1926.....	Mar. 15, 1922	Series A-1926
(e) 4¾ per cent notes, payable Dec. 15, 1925.....	June 15, 1922	Series B-1925

**391** 3. For the calculation of accrued interest on the current coupons of Treasury notes tendered in payment of estate or inheritance taxes under this circular, the method outlined in Exhibit B [¶383-384] to Department Circular No. 225, dated January 31, 1921, should be followed. Interest tables at the various rates borne by Treasury notes may be obtained from the Treasury Department, Division of Loans and Currency, Washington. The interest tables appropriate for use in connection with the issues of Treasury notes at present outstanding are as follows:

Form General 1017, for Series A-1924 (interest dates June 15 and December 15).



**INDEXED SUPPLEMENTARY ESTATE TAX REGULATIONS, ETC.***Forward references to which are embodied in the foregoing Regulations 63.*

Form General 1016, for Series B-1924 (interest dates March 15 and September 15).

Form L. & C. 369, for Series A-1925 prior to September 15, 1922 (interest during this period is on annual 365-day basis).

Form L. & C. 435, for Series A-1925 subsequent to September 15, 1922 (interest dates March 15 and September 15).

Form L. & C. 435, for Series A-1926 (interest dates March 15 and September 15).

**392** Interest tables or decimals for computing interest as may be required for other or future issues may be obtained from the Treasury Department, Division of Loans and Currency, Washington, upon request. (Extension of Department Circular No. 225, signed by Secretary A. W. Mellon, dated June 30, 1922 and appended to T. D. 3383.)

**393** **Transfer of stock: lien on stock and release of lien.**—Reference 230 is made to your letter of June 16. You are advised that in all cases where the estate of a deceased person is liable for the payment of Federal estate tax under the Revenue Act of 1918, the entire gross estate, as that term is defined in Section 402 of the said Act, is impressed with a lien to the extent of the tax liability of the said estate for a period of ten years from the date of the decedent's death, except as provided in Section 409. It is the ruling of this Bureau that under Section 409 only the following parts of a decedent's gross estate are divested of the lien. Such part of the gross estate as is used for the payment of charges against the estate and expenses of its administration, allowed by any court having jurisdiction thereof; and the value of any property included in the gross estate which was transferred, or with respect to which a trust was created by the decedent, in contemplation of or intended to take effect in possession or enjoyment at or after his death (except where the making of such transfer or the creating of such trust by the decedent constituted a bona fide sale for a fair consideration in money or money's worth), where the transferee or trustee has sold such property to a bona fide purchaser for a fair consideration in money or money's worth. No other part of the gross estate is divested of the lien by virtue of Section 409 of the said Act, nor may it be divested of such lien except by discharge of the tax liability of the estate or by a certificate issued by the Commissioner of Internal Revenue releasing it from the lien.

**394** It will be seen from the foregoing, therefore, that any stock of a corporation which was owned by a decedent on the date of his death is not divested of the lien by virtue of anything contained in Section 409 of the Revenue Act of 1918.

**395** This Bureau is at all times willing in any proper case to issue a release of lien with respect to any part of the gross estate where the tax liability of the estate has been discharged or provided for to the satisfaction of the Commissioner. Any transfer made by an executor of property forming a part of the gross estate of a decedent whose estate is liable for the payment of Federal estate tax, or the transfer by any person having in his possession property forming a part of such gross estate, except as provided in Section 409 aforesaid, will not operate to divest such property of the lien. (Letter to The Corporation Trust Company, signed by Deputy Commissioner James Hagerman, Jr., and dated June 26, 1920.)

**INDEXED SUPPLEMENTARY ESTATE TAX REGULATIONS, ETC.***Forward references to which are embodied in the foregoing Regulations 63.*

**396** No certificate releasing lien (waiver) required before transfer of  
**230** stock of a foreign corporation standing in the name of a nonresident decedent.—Referring to 60-day notice, on Form 705, filed for the estate of \_\_\_\_\_, deceased September 29, 1921, by the Guaranty Trust Company of New York, you are advised that the stock of the British American Tobacco Company may be transferred without a waiver from this office, as this is not stock of a corporation organized within the United States, and such stock is not taxable as a part of the decedent's gross estate in the United States. (Letter to Solomon Hanford, New York, N. Y., signed by Deputy Commissioner McKenzie Moss, and dated September 11, 1922.)



(Decision.)

(256 U. S. 345.—T. D. 3267.)

Revenue Act of 1916.

**Inheritance, legacy, succession, or transfer taxes are not deductible in the determination of the net estate subject to the Federal estate tax.**

SUPREME COURT OF THE UNITED STATES.

<p>New York Trust Company and Albert W. Pross, as Executors of the Will of J. Harsen Purdy, Plaintiffs in Error,  <i>vs.</i>  Mark Eisner.</p>	}	<p>In Error to the District Court of the United States for the Southern District of New York.</p>
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Mr. Justice HOLMES delivered the opinion of the Court.

**397** This is a suit brought by the executors of one Purdy to recover an  
**156** estate tax levied under the Act of Congress of September 8, 1916, c. 463, Title II, § 201, 39 Stat. 736, 777, and paid under duress on December 14, 1917. According to the complaint Purdy died leaving a will and codicil directing that all succession, inheritance and transfer taxes should be paid out of the residuary estate, which was bequeathed to the descendants of his brother. The value of the residuary estate was \$427,414.96, subject to some administration expenses. The executors had been required to pay and had paid inheritance and succession taxes to New York (\$32,988.97) and other States (\$4,780.91) amounting in all to \$37,-\$69.88. The gross estate as defined in § 202 of the Act of Congress was 7769,799.39; funeral expenses and expenses of administration, except the above taxes, \$61,322.08; leaving a net value for the payment of legacies, except as reduced by the taxes of the United States, of \$670,707.43. The plaintiffs were compelled to pay \$23,910.77 to the United States, no deduction of any part of the above mentioned \$37,769.88 being allowed. They allege that the Act of Congress is unconstitutional, and also that it was misconstrued in not allowing a deduction of state inheritance and succession taxes as charges within the meaning of § 203. On demurrer the District Court dismissed the suit.

**398** By § 201 of the Act, "a tax \* \* \* equal to the following percentage of the value of the net estate, to be determined as provided in section two hundred and three, is hereby imposed upon the transfer of the net estate of every decedent dying after the passage of this Act." \* \* \* with percentages rising from one per centum of the amount of the net estate not in excess of \$50,000 to ten per centum of the amount in excess of \$5,000,-000. Section 202 gives the mode of determining the value of the gross estate. Then, by § 203 it is enacted "That for the purpose of the tax the value of the net estate shall be determined—(a) In the case of a resident, by deducting from the value of the gross estate—(1) Such amounts for funeral expenses, administration expenses, claims against the estate, unpaid mortgages, losses incurred during the settlement of the estate arising from fires, storms, shipwreck, or other casualty, and from theft, when such losses are not compensated for by insurance or otherwise, support during the settle-



ment of the estate of those dependent upon the decedent, and such other charges against the estate, as are allowed by the laws of the jurisdiction, whether within or without the United States, under which the estate is being administered; and (2) an exemption of \$50,000." The tax is to be due in one year after the decedent's death. § 204. Within thirty days after qualifying the executor is to give written notice to the collector and later to make return of the gross estate, deductions allowed, net estate and the tax payable thereon. § 205. The executor is to pay the tax. § 207. The tax is a lien for two years on the gross estate except such part as is paid out for allowed charges, § 209, and if not paid within sixty days after it is due is to be collected by a suit to subject the decedent's property to be sold. § 208. In case of collection from some person other than the executor, the same section provides for contribution from or marshalling of persons subject to equal or prior liability "it being the purpose and intent of this title that so far as is practicable and unless otherwise directed by the will of the decedent the tax shall be paid out of the estate before its distribution." These provisions are assailed by the plaintiffs in error as an unconstitutional interference with the rights of the States to regulate descent and distribution, as unequal and as a direct tax not apportioned as the Constitution requires.

**399** The statement of the constitutional objections urged imports on its face a distinction that, if correct, evidently hitherto has escaped this Court. See *United States v. Field*, [¶403 herein]. It is admitted, as since *Knowlton v. Moore*, 178 U. S. 41, it has to be, that the United States has power to tax legacies, but it is said that this tax is cast upon a transfer while it is being effectuated by the State itself and therefore is an intrusion upon its processes, whereas a legacy tax is not imposed until the process is complete. An analogy is sought in the difference between the attempt of a State to tax commerce among the States and its right after the goods have become mingled with the general stock in the State. A consideration of the parallel is enough to detect the fallacy. A tax that was directed solely against goods imported into the State and that was determined by the fact of importation would be no better after the goods were at rest in the State than before. It would be as much an interference with commerce in one case as in the other. *I. M. Darnell & Son Co. v. Memphis*, 208 U. S. 113. *Welton v. Missouri*, 91 U. S. 275. Conversely if a tax on the property distributed by the laws of a State, determined by the fact that distribution has been accomplished, is valid, a tax determined by the fact that distribution is about to begin is no greater interference and is equally good.

**400** *Knowlton v. Moore*, 178 U. S. 41, dealt, it is true, with a legacy tax.

But the tax was met with the same objection; that it usurped or interfered with the exercise of state powers, and the answer to the objection was based upon general considerations and treated the 'power to transmit or the transmission or receipt of property by death' as all standing on the same footing. 178 U. S. 57, 59. After the elaborate discussion that the subject received in that case we think it unnecessary to dwell upon matters that in principle were disposed of there. The same may be said of the argument that the tax is direct and therefore is void for want of apportionment. It is argued that when the tax is on the privilege of receiving, the tax is indirect because it may be avoided, whereas here the tax is inevitable and therefore direct. But that matter also is disposed of by *Knowlton v. Moore*, not by an attempt to make some scientific distinction, which would be at least difficult, but on an interpretation of language by its traditional use—on the practical and historical ground that this kind of tax always has been

regarded as the antithesis of a direct tax; 'has ever been treated as a duty or excise, because of the particular occasion which gives rise to its levy.. 178 U. S. 81-83. Upon this point a page of history is worth a volume of logic,

**401** The inequalities charged upon the statute, if there is an intestacy' are all inequalities in the amounts that beneficiaries might receive in case of estates of different values, of different proportions between real and personal estate, and of different numbers of recipients; or if there is a will affect legatees. As to the inequalities in case of a will they must be taken to be contemplated by the testator. He knows the law and the consequences of the disposition that he makes. As to intestate successors the tax is not imposed upon them but precedes them and the fact that they may receive less or different sums because of the statute does not concern the United States.

**402** There remains only the construction of the Act. The argument against its constitutionality is based upon a premise that is unfavorable to the contention of the plaintiffs in error upon this point. For if the tax attaches to the estate before distribution—if it is a tax on the right to transmit, or on the transmission at its beginning, obviously it attaches to the whole estate except so far as the statute sets a limit. 'Charges against the estate' as pointed out by the Court below are only charges that affect the estate as a whole, and therefore do not include taxes on the right of individual beneficiaries. This reasoning excludes not only the New York succession tax but those paid to other States, which can stand no better than that paid in New York. What amount New York may take as the basis of taxation and questions of priority between the United States and the State are not open in this case.

*Decree affirmed.*



(Decision.)

(255 U. S. 257)

[T. D. 3150.]

**Gross estate does not include an interest passing under testamentary execution of a general power of appointment.**

(Act of Sept. 8, 1916, as amended by the Act of March 3, 1917.)

SUPREME COURT OF THE UNITED STATES.

The United States, Appellant,

vs.

Stanley Field, as Executor of the Estate  
of Kate Field, deceased.

} Appeal from the Court of Claims.

Mr. Justice PITNEY delivered the opinion of the Court.

**403** This is an appeal from a judgment of the Court of Claims sustaining  
132 a claim for refund of an estate tax exacted under Title II of the  
Revenue Act of September 8, 1916, as amended by Act of March 3,  
1917 (Ch. 463, 39 Stat. 756, 777; Ch. 159, 39 Stat. 1000, 1002). It presents  
the question whether the Act taxed a certain interest that passed under  
testamentary execution of a general power of appointment created prior but  
executed subsequent to its passage.

**404** The facts are as follows: Joseph N. Field, a citizen and resident of  
Illinois, died April 29, 1914, leaving a will which was duly admitted  
to probate in that State, and by which he gave the residue of his estate, after  
payment of certain legacies, to trustees, with provision that one-third of it  
should be set apart and held as a separate trust fund for the benefit of his  
wife, Kate Field, the net income to be paid to her during life, and from and  
after her death the net income of one-half of said share of the trust estate to  
be paid to such persons and in such shares as she should appoint by last will  
and testament. The trust was to continue until the death of the last sur-  
viving grandchild of the testator who was living at the time of his death, and  
at its termination the undistributed estate was to be divided among named  
beneficiaries or their issue, *per stirpes*, in proportions specified. Kate Field  
died April 29, 1917, a resident of Illinois, leaving a will which was duly pro-  
bated in that State, by which she executed the power of appointment, direct-  
ing that the income to which the power related should be paid in equal shares  
to her children surviving at the date of the respective payments, the issue of  
any deceased child to stand in the place of such deceased child. The collector  
of internal revenue, assuming to act under the Revenue Act of 1916, as  
amended, and Regulations issued by the Commissioner of Internal Revenue,  
included as a part of the gross estate of Kate Field the appointed estate  
passing under her execution of the power; and proceeded to assess and collect  
an estate tax based upon the net value thereof, and amounting to \$121,059.60.  
Her executor, having paid the tax under protest, and having made a claim  
for refund which was considered and rejected by the Commissioner of Internal  
Revenue, brought this suit and recovered judgment, from which the United  
States appeals.

**405** The Revenue Act of 1916, in sec. 201 (39 Stat. 777) imposes a tax  
equal to specified percentages of the value of the net estate "upon



the transfer of the net estate of every decedent dying after the passage of this Act." By sec. 203 (p. 778) the value of the net estate is to be determined by subtracting from the value of the gross estate certain specified deductions. The gross estate is to be valued as follows:

"Sec. 202. That the value of the gross estate of the decedent shall be determined by including the value at the time of his death of all property, real or personal, tangible or intangible, wherever situated:

"(a) To the extent of the interest therein of the decedent at the time of his death which after his death is subject to the payment of the charges against his estate and the expenses of its administration and is subject to distribution as part of his estate.

"(b) To the extent of any interest therein of which the decedent has at any time made a transfer, or with respect to which he has created a trust, in contemplation of or intended to take effect in possession or enjoyment at or after his death, except in case of a bona fide sale for a fair consideration in money or money's worth. Any transfer of a material part of his property in the nature of a final disposition or distribution thereof, made by the decedent within two years prior to his death without such a consideration, shall, unless shown to the contrary, be deemed to have been made in contemplation of death within the meaning of this title; . . . ."

**406** The amendment of March 3, 1917, (39 Stat. 1002), pertains merely to the rates, and need not be further considered.\*

**407** The provision quoted from sec. 202 was construed by the Treasury Department, in U. S. Internal Revenue Regulations No. 37, relating to Estate Taxes, revised May, 1917, Art. XI, as follows: "Property passing under a general power of appointment is to be included as a portion of the gross estate of a decedent appointor."

**408** No question being suggested as to the power of Congress to impose a tax upon the passing of property under testamentary execution of a power of appointment created before but executed after the passage of the taxing act (See *Chandler v. Kelsey*, 205 U. S. 466, 473, 478-479; *Knowlton v. Moore*, 178 U. S. 41, 56-61), the case involves merely a question of the construction of the Act. Applying the accepted canon that the provisions of such acts are not to be extended by implication (*Gould v. Gould*, 245 U. S. 151, 153), we are constrained to the view—notwithstanding the administrative construction adopted by the Treasury Department—that the Revenue Act of 1916 did not impose an estate tax upon property passing under a testamentary execution of a general power of appointment.

**409** The Government seeks to sustain the tax under both clauses above quoted from sec. 202.

**410** The conditions expressed in clause (a) are to the effect that the taxable estate must be (1) an interest of the decedent at the time of his death, (2) which after his death is subject to the payment of the charges against his estate and the expenses of its administration, and (3) is subject to distribution as part of his estate. These conditions are expressed conjunctively; and it would be inadmissible, in construing a taxing act, to read them as if prescribed disjunctively. Hence, unless the appointed interest fulfilled all three conditions, it was not taxable under this clause.

**411** The chief reliance of the Government is upon the rule, well established in England and followed generally, but not universally, in this

\*The Act was further amended October 3, 1917, (Ch. 63, 40 Stat. 300, 324); superseded and repealed by Act of February 24, 1919 (Ch. 18, 40 Stat. 1057, 1096, 1149).

country, that where one has a general power of appointment either by deed or by will, and executes the power, equity will regard the property appointed as part of his assets for the payment of his creditors in preference to the claims of his voluntary appointees. See *Brandies v. Cochrane*, 112 U. S. 344, 352.

**412** The English cases are fully reviewed by the House of Lords in *O'Grady v. Wilmot* (1916) 2 A. C. 231, 246, *et seq.* Illustrative cases in the American courts are *Johnson v. Cushing*, 15 N. H. 298, 307; *Rogers v. Hinton*, 62 N. C. 101, 105; *Clapp v. Ingraham*, 126 Mass. 200, 202; *Knowles v. Dodge*, 1 Mack. (D. C.) 66, 72; *Freeman v. Butters*, 94 Va. 406, 411; *Tallmadge v. Sill*, 21 Barb. 34, 51, *et seq.*; *contra per* Gibson, C. J., in *Commonwealth v. Duffield*, 12 Pa. 277, 279-281; *Pearce v. Lederer*, 262 Fed. Rep. 993; *affirmed*, *Lederer v. Pearce*, 266 Fed. Rep. 497.

**413** It is tacitly admitted that the rule obtains in Illinois, and we shall so assume.

**414** But the existence of the power does not of itself vest any estate in the donee. *Collins v. Wickwire*, 162 Mass. 143, 144; *Keays v. Blinn*, 234 Ill. 121, 124; *Walker v. Treasurer*, 221 Mass. 600, 602-603; *Shattuck v. Burrage*, 229 Mass. 448, 451. See *Carver v. Jackson*, 4 Pet. 1, 93.

**415** Where the donee dies indebted, having executed the power in favor of volunteers, the appointed property is treated as equitable, not legal, assets of his estate; *Clapp v. Ingraham*, 126 Mass. 200, 203; *Patterson Co. v. Lawrence*, 83 Ga. 703, 707; and (in the absence of statute), if it passes to the executor at all, it does so not by virtue of his office but as a matter of convenience and because he represents the rights of creditors. *O'Grady v. Wilmot* (1916) 2 A. C. 231, 248-257; *Smith v. Garey*, 2 Dev. & Bat. Eq. (N.C.) 42, 49; *Olney v. Balch*, 154 Mass. 318, 322; *Emmons v. Shaw*, 171 Mass. 410, 411; *Hill v. Treasurer*, 229 Mass. 474, 477.

**416** Where the power is executed, creditors of the donee can lay claim to the appointed estate only to the extent that the donee's own estate is insufficient to satisfy their demands. *Patterson Co. v. Lawrence*, 83 Ga. 703, 708; *Walker v. Treasurer*, 221 Mass. 600, 602-603; *Shattuck v. Burrage*, 229 Mass. 448, 452.

**417** It is settled that (in the absence of statute) creditors have no redress in case of a failure to execute the power. *Holmes v. Coghill*, 7 Ves; 499, 507, *affirmed*, 12 Ves. 206, 214-215; *Gilman v. Bell*, 99 Ill. 144, 150. *Duncanson v. Manson*, 3 App. D. C. 260, 273.

**418** And, whether the power be or be not exercised, the property that was subject to appointment is not subject to distribution as part of the estate of the donee. If there be no appointment, it goes according to the disposition of the donor. If there be an appointment to volunteers, then, subject to whatever charge creditors may have against it, it goes not to the next of kin or the legatees of the donee, but to his appointees under the power.

**419** It follows that the interest in question, not having been property of Mrs. Field at the time of her death, nor subject to distribution as part of her estate, was not taxable under clause (a).

**420** We deem it equally clear that it was not within clause (b). That clause is the complement of (a), and is aptly descriptive of a transfer of an interest in decedent's own property in his life time, intended to take effect at or after his death. It cannot, without undue laxity of construction, be made to cover a transfer resulting from a testamentary execution by decedent of a power of appointment over property not his own.



**421** It would have been easy for Congress to express a purpose to tax property passing under a general power of appointment exercised by a decedent had such a purpose existed; and none was expressed in the Act under consideration. In that of February 24, 1919, which took its place, the section providing how the value of the gross estate of the decedent shall be determined contains a clause precisely to the point (sec. 402 (e), 40 Stat. 1097); "To the extent of any property passing under a general power of appointment exercised by the decedent (1) by will, or (2) by deed executed in contemplation of, or intended to take effect in possession or enjoyment at or after, his death, except", etc. Its insertion indicates that Congress at least was doubtful whether the previous Act included property passing by appointment. See *Matter of Miller*, 110 N. Y. 216, 222; *Matter of Harbeck*, 161 N. Y. 211, 217-218; *United States v. Bashaw*, 50 Fed. Rep. 749, 754. The Government contends that the amendment was made for the purpose of clarifying rather than extending the law as it stood, and cites a statement to that effect in the Report of the House Committee on Ways and Means (House Doc. No. 1267, p. 101, 65th Cong. 2d Sess.). It is evident, however, that this statement was based upon the interpretation of the Act of 1916 adopted by the Treasury Department; the same report proceeded to declare (p. 102) that "The absence of a provision including property transferred by power of appointment makes it possible, by resorting to the creation of such a power, to effect two transfers of an estate with the payment of only one tax;" and this, together with the fact that the committee proposed that the law be amended, shows that the Treasury construction was not treated as a safe reliance.

**422** The tax in question being unsupported by the taxing act, the Court of Claims was right in awarding reimbursement.

*Judgment affirmed.*



(Decision.)

(Revenue Act of 1916.—T. D. 3326.)

State and municipal bonds held by decedent to be included in determining value of gross estate for purposes of the tax.

SUPREME COURT OF THE UNITED STATES.

Mary Louise Greiner, Executrix, etc., Plaintiff in Error, vs. C. G. Lewellyn, Collector of Internal Revenue.	}	In Error to the District Court of the United States for the Western District of Pennsylvania. [April 10, 1922.]
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Mr. Justice BRANDEIS delivered the opinion of the Court.

**423** This action was brought in the federal court for Western Penn-  
76 sylvania against the Collector of Internal Revenue to recover part  
of an amount assessed as estate tax under the Act of September 8,  
1916, c. 463, Title II, 39 Stat. 756, 777, and paid by the plaintiff as executrix  
of the estate of Kate B. Kingsley. In determining the net value of the  
estate upon the transfer of which the tax was imposed, the Collector had  
included bonds issued by political subdivisions of the State of Pennsylvania.  
The executrix claimed that to include these municipal bonds was in effect  
to tax them—which the Federal Government is under the Constitution  
without power to do. *Pollock v. Farmers' Loan & Trust Co.*, 157 U. S. 429,  
583, 654; 158 U. S. 601, 618, 693. The District Court overruled this claim  
and entered judgment for defendant. The case comes here on writ of error  
under Section 238 of the Judicial Code. Whether Congress has power to  
require that state and municipal bonds held by a decedent be included for  
the purpose of determining the net value on which the estate tax is imposed  
is the sole question presented for decision.

**424** That the Federal Government has power to tax the transmission of  
legacies was settled by *Knowlton v. Moore*, 178 U. S. 41; and that  
it has the power to tax the transfer of the net assets of a decedent's estate  
was settled by *New York Trust Co. v. Eisner*, 256 U. S. 345 [¶397]. The  
latter case has established also that the estate tax imposed by the Act  
of 1916, like the earlier legacy or succession tax, is a duty or excise, and not  
a direct tax like that on income from municipal bonds. *Pollock v. Farmers'  
Loan & Trust Co.*, *supra*. A State may impose a legacy tax on a bequest  
to the United States, *United States v. Perkins*, 163 U. S. 625, or on a bequest  
which consists wholly of United States bonds, *Plummer v. Coler*, 178 U. S.  
115; *Orr v. Gilman*, 183 U. S. 278 [see ¶307]. Likewise the Federal Govern-  
ment may impose a succession tax upon a bequest to a municipal corporation  
of a State, *Snyder v. Bettman*, 190 U. S. 249, or may, in determining the  
amount for which the estate tax is assessable, under the Act of 1916, include  
sums required to be paid to a State as inheritance tax, for the estate tax is  
the antithesis of a direct tax, *New York Trust Co. v. Eisner*, *supra*. Municip-  
al bonds of a State stand in this respect in no different position from money  
payable to it. The transfer upon death is taxable, whatsoever the character  
of the property transferred and to whomsoever the transfer is made. It  
follows that in determining the amount of decedent's net estate municipal  
bonds were properly included.

*Affirmed.*

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WAR TAX 133 SERVICE

(Decision.)

(Revenue Act of 1916.—T. D. 3339.)

The text of the 1916 Act is not to be construed as applying to transfers in contemplation of death, etc., completed before the passage of the Act.

## SUPREME COURT OF THE UNITED STATES.

Victor E. Shwab, Executor of the last  
will and testament of Augusta J.  
Dickel, Deceased, Plaintiff in Error,

vs.

Emanuel J. Doyle, United States Col-  
lector of Internal Revenue for the  
Fourth Collection District of Michi-  
gan.

In Error to the United  
States Circuit Court of  
Appeals for the Sixth  
Circuit.

REVENUE ACT OF 1916 [May 1, 1922.]

Mr. Justice McKENNA delivered the opinion of the Court.

**425** Augusta Dickel by a deed dated April 21, 1915, assigned and delivered  
118 to the Detroit Trust Company, stocks, bonds or securities of the  
120 declared value of \$1,000,000—with all their unmatured coupons,  
and the proceeds to be derived therefrom, both principal and income,  
in trust to invest and reinvest and to pay the net income for life to  
Victor E. Shwab or on his written order. After his death the net income was  
directed to be paid to six beneficiaries, his children. A power of delegating  
and selling or exchanging all securities was given to Shwab, and of reinvest-  
ment. During the life of Shwab the net income was to be paid to him or his  
order. After his death the trust was to continue during the lives of the  
beneficiaries and the net income was to be paid to them during their respective  
lives in equal shares.

**426** There were other rights and powers given to plaintiff and the bene-  
ficiaries not necessary to mention.

**427** The trust deed was accepted by the Detroit Trust Company on or  
before June 3, 1915.

**428** Augusta Dickel died September 16, 1916, possessed of an estate of  
\$800,000. Seven days before her death Congress passed an act  
entitled, "Estate Tax Act," 39 Stat. 777-780. The Act provided that accord-  
ing to certain percentages of the value of the net estate, a tax was to be im-  
posed upon the transfer of the net estate of every decedent dying after the  
passage of the Act, "to the extent of any interest therein of which the de-  
cedent has at any time made a transfer, or with respect to which he has created  
a trust, in contemplation of or intended to take effect in possession or enjoy-  
ment at or after his death, except in case of a bona fide sale for a fair con-  
sideration in money or money's worth. Any transfer of a material part of  
his property in the nature of a final disposition or distribution thereof, made  
by the decedent within two years prior to his death without such a considera-  
tion, shall, unless shown to the contrary, be deemed to have been made in  
contemplation of death within the meaning of this title."

**429** Under the assumption that the Act was applicable to the deed made  
by Augusta Dickel to the Detroit Trust Company a tax was assessed  
and exacted from plaintiff in error (here called plaintiff) in the sum of  
\$56,548.41. Plaintiff paid it under protest and then to recover it brought



this action in the District Court of the United States for the Western District of Michigan, Southern Division.

**430** A jury being impaneled to try the case, the plaintiff presented his contentions in requests for charges. These were, (1) to find for plaintiff. (2) Upon refusal of the court to so charge but not otherwise, that the deed of Mrs. Dickel to the Detroit Trust Company took effect more than a year before the enactment of the Act of September 8, 1916, that is, took effect immediately, not in possession or enjoyment at or after the death of Mrs. Dickel. (3) The words "in contemplation of death" do not refer to that general expectation of death which every mortal entertains, but rather the apprehension which arises from some existing condition of body or some impending peril. (4) If Mrs. Dickel when she made the trust deed was not in that apprehension arising from that condition of body or of an impending peril, it was not made within the meaning of the Act of Congress. (5) Mrs. Dickel having made the deed before the Act of Congress was passed, her purpose was not to defeat or evade the Federal Revenue Law.

**431** There were other requests for instructions to the jury not material to be considered except that the Act of Congress was not retrospective in character and, therefore, did not impose a tax on the deed from Mrs. Dickel to the Trust Company. And that if it could be considered to have that character and effect, it would be unconstitutional and void as a denial of due process of law, and the taking of private property for public use without just compensation, contrary to the Fourteenth Amendment of the Constitution of the United States.

**432** The court ruled against all of the requests so far as the court considered them as presenting questions of law, but considered that whether the trust deed was made in contemplation of death was a question for the jury and submitted it to them, with aiding and defining explanations, and concluded by declaring, "the whole question is the question whether the transfer was made in contemplation of death; that is all there is to it."

**433** The verdict of the jury was in favor of the defendant, upon which judgment was duly entered. It was affirmed by the Circuit Court of Appeals (269 Fed. 321), to the action of which this writ of error is directed.

**434** Plaintiff urges against the judgment of the Circuit Court of Appeals all of the contentions presented in his requests made to the District Court for instructions to the jury, but so diverse and extensive consideration is only necessary if the Act of Congress be of retrospective operation. To that proposition we shall, therefore, address our attention.

**435** The initial admonition is that laws are not to be considered as applying to cases which arose before their passage unless that intention be clearly declared. 1 Kent. 455; *Eidman v. Martinez*, 184 U. S. 578; *White v. United States*, 191 U. S. 545; *Gould v. Gould*, 245 U. S. 151; Story, Const., Sec. 1398. The comment of Story is, "retrospective laws are, indeed, generally unjust; and, as has been forcibly said, neither accord with sound legislation nor with the fundamental principles of the social compact."

**436** There is absolute prohibition against them when their purpose is punitive; they then being denominated *ex post facto* laws. It is the sense of the situation that that which impels prohibition in such case exacts clearness of declaration when burdens are imposed upon completed and remote transactions, or consequences given to them of which there could have been no foresight or contemplation when they were designed and consummated.

**437** The Act of September 8, 1916, is within the condemnation.

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**438** There is certainly in it no declaration of retroactivity, "clear, strong and imperative," which is the condition expressed in *United States v. Heth*, 3 Cranch 398, 413; also *United States v. Burr*, 159 U. S. 78, 82-83.

**439** If the absence of such determining declaration leaves to the statute a double sense, it is the command of the cases, that that which rejects retroactive operation must be selected.

**440** The circumstances of this case impel to such selection. If retroactivity be accepted, what shall mark its limit? The Circuit Court of Appeals found the interrogation not troublesome. It said, "Congress would, we think, scarcely be impressed with a practical likelihood that a transfer made many years before a grantor's death (say twenty-five years, to use plaintiff's suggestion) would be judicially found to be made in contemplation of death under the legal definition applicable thereto, and without the aid of the two years *prima facie* provision." In other words, the sense of courts and juries, good or otherwise, might, against the words of the statute, and against what might be the evidence in the case, unhelpt by the presumption declared, fix the years of its retrospect. This would seem to make the difficulty or ease of proof a substitute for the condition which the statute makes necessary to the imposition of the tax, that is, the disposition with which the transfer is made; and certainly whether that disposition exist at an instant before death or years before death, it is a condition of the tax.

**441** The construction of the Government is more tenable though more unrestrained. It accepted in bold consistency, at the oral argument, the challenge of twenty-five years, and a ruling of the Commissioner of Internal Revenue, in bolder confidence, extends the statute to "transfers of any kind made in contemplation of death *at any time whatsoever* (italics ours) prior to September 8, 1916." The sole test in the opinion of that officer is "the date of the death of the decedent." He fixes no period to the retrospect he declares, but reserves, if he be taken at his word, the transfers of all times to the demands of revenue. In this there is much to allure an administrative officer. Indeed, its simplicity attracts anyone. It removes puzzle from construction and perplexity and pertinence on account of the distance of death from the transfer, risking no chances of courts or juries, in repugnance or revolt, taking liberties with the Act to relieve from its exactions to the demands of revenue.

**442** If Congress, however, had the purpose assigned by the Commissioner it should have declared it; when it had that purpose it did declare it. In the Revenue Act of 1918 it reenacted Section 202 of the Act of September 8, 1916, and provided that the transfer or trust should be taxed whether "made or created before or after the passage of" the Act. And we cannot accept the explanation that this was an elucidation of the Act of 1916, and not an addition to it, as averred by defendant, but regard the Act of 1918 rather as a declaration of a new purpose; not the explanation of an old one. But granting the contention of the defendant has plausibility, it is to be remembered that we are dealing with a tax measure and whatever doubts exist must be resolved against it.

**443** This we have seen is the declaration of the cases and this the basis of our decision, that is, has determined our judgment against the retroactive operation of the statute. There are adverse considerations and the Government has urged them all. To enter into a detail of them or of the cases cited to sustain them and of those cited to oppose them, either directly or in tendency, and the examples of the States for and against them,

would extend this opinion to repellent length. We need only say that we have given careful consideration to the opposing argument and cases, and a careful study of the text of the Act of Congress, and have resolved that it should be not construed to apply to transactions completed when the Act became a law. And this, we repeat, is in accord with principle and authority. It is the proclamation of both that a statute should not be given a retrospective operation unless its words make that imperative and this cannot be said of the words of the Act of September 8, 1916.

*Judgment reversed.*



(Decision.)

(Revenue Act of 1916.—T. D. 3338.)

The text of the 1916 Act is not to be construed as applying to transfers intended to take effect in possession or enjoyment at or after death, etc., which transfers were completed before the passage of the Act.

## SUPREME COURT OF THE UNITED STATES.

Union Trust Company of San Francisco and  
Albert Lachman, as Executors of the last  
will and testament of Henriette S. Lach-  
man, deceased, Plaintiffs in Error,

vs.

Justus S. Wardell, United States Collector of  
Internal Revenue for the First District of  
California, and John L. Flynn, United  
States Collector of Internal Revenue for the  
First District of California.

In Error to the District Court  
of the United States for the  
Northern District of Cal-  
ifornia.

[May 1, 1922.]

Mr. Justice McKENNA delivered the opinion of the Court.

**444** This case was argued at the same time and submitted with No. 200,  
118 *Shwab v. Doyle*, just decided [¶425]. It involves, as that case did,  
122 the Estate Tax Act of September 8, 1916, and its different facts  
illustrate and aid the principle upon which that case was decided.

**445** Plaintiffs in error are executors of the last will and testament of  
Henriette S. Lachman, deceased. They were also parties to a trust  
deed made by her during her lifetime. They sued defendant in error Wardell,  
he then being United States Collector of Internal Revenue for the First  
District of California to recover the sum of \$4,545.50 that being the amount  
of a tax assessed against the estate of Henriette S. Lachman, upon the value  
of 4,985 shares of stock transferred in trust by Henriette S. Lachman to  
trustees upon the assumption that the Act of Congress of September 8, 1916  
was applicable to the trust.

**446** The following is a summary of the facts stated narratively. On  
May 31, 1901, Henriette S. Lachman was the owner of 7,475 shares of  
capital stock of the S. & H. Lachman Estate, a corporation. On that date  
she executed and delivered to Albert Lachman and Henry Lachman, her sons,  
the following instrument:

"Almeda, Cal., May 31, 1901.

"To Albert Lachman and Henry Lachman, my sons:

"This is to certify that I have delivered to you seven thousand four  
hundred and seventy-five (7,475) shares of the capital stock of the S. & H.  
Lachman Estate, represented by certificates, numbers eleven (11), twelve  
(12) and thirteen (13) respectively, however, upon the following trust:

"To pay to me during my lifetime, all the income earned and derived  
therefrom, and, upon my death, to deliver two thousand four hundred and  
ninety (2,490) shares, respectively by certificates number eleven (11) unto  
Henry Lachman, thenceforth for his absolute property; two thousand four  
hundred and ninety-five (2,495) shares, represented by certificate number  
thirteen (13) unto Albert Lachman, thenceforth for his absolute property;  
and yourselves, to-wit, Albert and Henry Lachman, to hold two thousand



four hundred and ninety (2,490) shares, represented by certificate number twelve (12) upon my death, in trust paying the income derived therefrom unto my daughter, Rebecca, wife of Leo Metzger, and upon the death of my said daughter, the income and earnings derived from said two thousand four hundred and ninety (2,490) shares shall be held, or expended, by you, according to your judgment, for the benefit of my grandchildren, the children of my said daughter, Rebecca Metzger, and upon the youngest of said children attaining the age of majority, all the then surviving children of my said daughter, Rebecca Metzger, shall be immediately entitled to said two thousand four hundred and ninety (2,490) shares in equal proportions.

Henriette Lachman."

**447** The requirements of the deed were performed upon the contingencies occurring for which it provided.

**448** On November 14, 1916, Henriette S. Lachman died, being then a resident of Alameda County, California, leaving an estate of the value of \$302,963.64, which included 2,490 shares of the stock that passed to her upon the death of her husband and 25 shares of stock in a business that had been conducted by her husband but did not include the transfer of the 4,985 shares included in the trust deed.

**449** The will was duly probated and the tax under the Act of September 8, 1916, was paid on the property which passed under her will, but no tax was paid on the 4,985 shares transferred 15 years before by the trust deed.

**450** The Commissioner having ruled that those shares were subject to a tax, assessed against them the sum of \$4,545.50. It was paid under protest and this action was brought for its recovery.

**451** Wardell demurred to the complaint on the ground that it did not state facts sufficient to constitute a cause of action against him. The demurrer was sustained and judgment entered dismissing the complaint.

**452** Stating the contention of the plaintiffs, the court said it was that "the act should not be construed as to include transfers made prior to its passage, and that if it be so construed the act is unconstitutional." The court observed that "both of these questions were determined adversely to the plaintiffs by the Circuit Court of Appeals for the Eighth Circuit in *Shwab, Executor v. Doyle*, not yet reported." And said further, "In that case the transfer was made in contemplation of death, whereas in the present case the transfer was intended to take effect in possession or enjoyment at or after death, but manifestly the same rule of construction will apply to both provisions, and the same rule of constitutional validity."

**453** The court, while apparently relying on *Shwab v. Doyle*, declared that it entertained "no doubt that the act was intended to operate retrospectively, and a contrary construction could only be justified on the principle that such a construction would render the act unconstitutional."

**454** The same contentions are made against and for the ruling of the court as were made in *Shwab v. Doyle*. It is not necessary to repeat them. They are, with but verbal variations, the same as in *Shwab v. Doyle*, and the Commissioner so considering, submits this case upon his brief in that.

**455** We have there stated them and passed judgment upon that which we think determines the case, that is, the retroactivity of the Act of September 8, 1916. The facts in this case fortify the reasoning in that. In this case the Act is given operation against an instrument executed 15 years before the passage of the Act.

**456** The record exhibits proceedings that should be noticed. The demurrer of Wardell was sustained to the complaint, and a judgment of dismissal entered January 13, 1921.

**457** On February 2, 1921, plaintiffs gave notice of a motion to substitute John S. Flynn as defendant in the place and stead of Wardell in so far as the action was against Wardell in his official capacity, and to permit it to be continued and prosecuted against him so far as it was against him personally.

**458** The grounds of the motion were stated to be that he had resigned and Flynn had been appointed his successor and was then the acting Collector.

**459** On February 7, 1921, the motion was granted. The order of the court recited the resignation of Wardell and the succession of Flynn. And it being uncertain as to whether this was a proper case for the substitution of Flynn or was one which should proceed against Wardell, and it appearing to the court on motion of plaintiffs that it was necessary for the survivor to obtain a settlement of the questions involved, it was ordered that so far as the action was against Wardell in his official capacity, it might be sustained against Flynn as his successor, and that so far as it was against Wardell personally, it should be continued against him. And it was ordered that the action should thereafter proceed against Flynn and Wardell without further pleadings or process.

**460** On February 9, 1921, Flynn filed an appearance by attorneys which recited that he had been substituted in the place of Wardell in so far as the action was against Wardell in his official capacity, and thereby appeared in the action as such defendant.

**461** It will be observed that there was no resistance to the motion of substitution of Flynn nor exception by him, and that he almost immediately appeared in the action in compliance with the order of the court. The subsequent proceedings were directed as much against him as against Wardell, the bond upon the writ of error running to both.

**462** However, this Court decided in *Smietanka, Collector v. Indiana Steel Company*, October 24th of this term, that a suit may not be brought against a Collector of Internal Revenue for the recovery of a tax, in the collection and disbursement of which, such officer had no agency. We think the bringing of Flynn into the case was error. Therefore, upon the return of the case to the District Court, he shall be permitted to set up the defense of non-liability, if he be so advised, and, if he set up the defense, it shall be ruled as sufficient for the reasons we have given.

*Judgment reversed and cause remanded for further proceedings in accordance with this opinion.*



(Decision.)

(Revenue Act of 1916.)

The text of the 1916 Act is not to be construed as applying to transfers in contemplation of death, etc., completed before the passage of the Act.

SUPREME COURT OF THE UNITED STATES.

Harriet L. Levy, Pauline Jacobs and Adeline  
Salinger, Plaintiffs in Error,

vs.

Justus S. Wardell, United States Collector of  
Internal Revenue for the First District of  
California, and John L. Flynn, United States  
Collector of Internal Revenue for the First  
District of California.

In Error to the District  
Court of the United  
States for the Northern  
District of California.

[May 1, 1922.]

Mr. Justice McKenna delivered the opinion of the Court.

**463** The case was determined in the court below upon demurrer to the  
118 complaint. The complaint alleged that on the 19th day of December,  
122 1902, and for sometime prior thereto, Henriette Levy was the owner  
of 22,014 shares of the capital stock of the Levy Estate Company, a  
corporation. On that date she conveyed to the plaintiffs Harriet L. Levy,  
Pauline Jacobs and Adeline Salinger, each 5,000 shares of that stock. On  
the 14th day of January, 1903, she conveyed to these plaintiffs 2,660 shares  
each.

**464** On the 17th day of January, 1907, she and the plaintiffs entered  
into an agreement, which recited errors made in the issue of the  
stock, and agreed that the number of shares to which each was entitled was  
as follows: to Henriette Levy 10 shares, to Harriet L. Levy 7,328 shares, to  
Pauline Jacobs 7,338 shares, to Adeline Salinger 7,337 shares and to Ruth  
Salinger 1 share.

**465** On the same date the agreement was carried out by the board of  
directors of the company, and on that date Henriette Levy conveyed  
her 10 shares to Harriet L. Levy.

**466** The transfers of the stock to plaintiffs were complete and there were  
no agreements or stipulations by which Henriette Levy would be  
entitled to a return of the stock except that the plaintiffs promised and agreed  
to pay to her the dividends accruing thereon during her lifetime, she, however,  
retaining no testamentary disposition or any legal right whatsoever over the  
stock or any of it, or any right of revocation.

**467** Henriette Levy at the time of the transfers was in good health and  
made them to get rid of the care and worry of business and to vest  
in plaintiffs definite and irrevocable present rights of ownership in the stock,  
and the transfers were not in contemplation of, or intended to take effect in  
possession or enjoyment at or after her death.

**468** She died on the 15th day of December, 1916, being at that time, and  
at the time of the transfers, a resident of Alameda County, California.  
Plaintiffs are her surviving children and were at such time, and are now,  
residents of the State.

**469** She left no property or estate or assets whatever, and consequently,  
there was no estate to administer, nor any estate upon which any



tax could be levied. Notwithstanding the facts, the Commissioner of Internal Revenue of the United States, assuming to act under the provisions of the Act of September 8, 1916, attempted to levy and assess a tax in the sum of \$12,460.84, and demanded and threatened to enforce payment of the same. In consequence thereof the plaintiffs paid the tax. Subsequently they demanded a refund of the tax which demand was refused.

**470** At the time of the transfers there was no law of the State of California imposing any transfer or inheritance tax, nor was there a law of the United States to that effect, and all of the transfers were intended to take effect in possession and enjoyment upon their date. The Act of Congress, therefore, should not be construed to be retroactive, and if so construed, was in violation of the Constitution of the United States in that it would take the property of plaintiffs without due process of law in violation of the Fifth Amendment, and would not be, besides, a transfer tax or an indirect tax but would be a direct tax thereon in violation of Article 1, Section 9, subdivision 4 of the Constitution of the United States because not laid in proper relation to census or enumeration as therein provided.

**471** Judgment was prayed for the sum of \$12,460.84 with interest from the 26th day of December, 1917.

**472** Wardell filed a demurrer to the complaint which was sustained, and the action dismissed. To that judgment this writ of error is directed. For the reasons stated in *Shwab v. Doyle* [¶425], we think the judgment was erroneous.

**473** There was a proceeding in the case to which we must give attention. The judgment of dismissal was entered January 20, 1921. On February 14, 1921, an order of the court was made and entered which recited the resignation of Wardell as Collector and the appointment of John L. Flynn as Collector, and as doubts existed as to whether the case was proper for the substitution of Flynn as successor of Wardell, it was ordered that so far as the action was against Wardell in his official capacity, the same might be maintained against Flynn, and that so far as it was against Wardell personally, it might be continued against him personally without further pleadings or process.

**474** On February 15, 1921, Flynn entered his appearance which, after reciting the fact of his substitution as defendant in place of Wardell, in so far as the action was against Wardell in his official capacity, declared that he, Flynn, appeared in the "action as such defendant."

**475** It will be observed that there was no resistance by Flynn to his substitution and the subsequent proceedings were directed as much against him as against Wardell, the bond upon the writ of error running to both. As we have said, however, in *Union Trust Company et al. v. Wardell and Flynn* (No. 236) [¶444], this Court decided in *Smietanka, Collector v. Indiana Steel Company*, October 24th of this term, that an action could not be maintained against a Collector of Internal Revenue for the recovery of a tax in the collection and disbursement of which he had no agency.

**476** This was Flynn's situation and bringing him into the case was error. Therefore, upon return of the case to the District Court he shall be permitted to set up the defense of non-liability, if so advised, and, if he set up the defense, it shall be ruled as sufficient for the reasons we have given.

*Judgment reversed and cause remanded for further proceedings in accordance with this opinion.*

(Decision.)  
(Revenue Acts of 1916-1917.)

The text of the 1916 Act is not to be construed as applying to transfers in contemplation of death, etc., completed before the passage of the Act.

SUPREME COURT OF THE UNITED STATES.

John C. Knox, as surviving executor of the last will and testament of Jonas B. Kissam, deceased, et al., Plaintiffs in Error,

In Error to the United States Circuit Court of Appeals for the Second Circuit.

vs.  
Richard J. McElligott, as late Collector of Internal Revenue for the Third District of New York.

[May 1, 1922.]

Mr. Justice McKenna delivered the opinion of the Court.

**477** This case involves the same principles and contentions passed on in  
118 Nos. 200 [¶340], 236 [¶444] and 303 [¶463]. It, as they, is an action  
122 to recover a tax (\$11,819.74) assessed by the Commissioner of Internal Revenue as an additional estate tax on the estate of Jonas B. Kissam, deceased, under the Act of September 8, 1916, as amended in 1917. It, the action, was brought in the United States District Court for the Southern District of New York.

**478** The complaint was a voluminous paper and contained at least four causes of action. As to the first, consisting of twenty-two paragraphs, Elligott filed a demurrer. Plaintiff made a motion for judgment on the pleadings. The motion was granted and a final judgment was awarded against "defendant on the merits for the relief prayed for in the first cause of action set forth" in the complaint.

**479** The judgment was reversed by the Circuit Court of Appeals, 275 Fed. 546.

**480** The following four paragraphs are a summary of the allegations of the complaint stated narratively:

**481** In 1912 the decedent, Jonas B. Kissam, was the owner of certain bonds and mortgages and corporate bonds. In that year he conveyed the property to the plaintiff in error, John C. Knox who, shortly thereafter, reconveyed the same to Kissam and his wife Cornelia B. Kissam, as joint tenants. All of the parties resided in the State of New York.

**482** In 1917 Kissam died leaving Mrs. Kissam surviving him. She was made one of the executors of the will as well as sole beneficiary thereunder.

**483** On December 7, 1917, she as executrix and Knox as executor, made a return of the Federal Estate Tax on the entire estate of Jonas B. Kissam. They included in the return the value of one-half of the jointly owned property which was owned and enjoyed by decedent, but did not include the value of the one-half of the jointly owned property which had been owned and enjoyed by Mrs. Kissam since the creating of the joint estates in July and August of 1912.

**484** A tax of \$5,354.14 based upon the return was paid by the plaintiffs in error. On May 9, 1919, the Commissioner of Internal Revenue added to the estate the one-half interest of the value of the estate and assessed



as a tax in addition to that which was paid, the sum of \$13,668.60. The additional tax was paid under protest and to recover it is the purpose of the action.

**485** The Circuit Court of Appeals stating the contention of the executors said, that "they claimed that the assessment was void as to the half of the joint property which vested in Cornelia [Mrs. Kissam] before the passage of the Act of September 8, 1916, as amended, and also that the Act itself was unconstitutional as a direct tax upon property without apportionment among the several States as required by Article 1, Section 9, Subdivision 4, of the Constitution."

**486** But this contention was the alternative of the contention which plaintiffs in error also made, that the Act of September 8, 1916, as amended, was not intended to have retrospective operation. And this was the decision of the District Court, the court saying, "It is true section 201 provides that the tax is imposed upon the transfer of the net estate of 'every decedent dying after the passage of this Act'; but the assumption must be that this relates to estates thereafter created and not to then existing property." And the court added "At the time the statute was passed Cornelia Kissam's interest belonged to her." The court further observed, "From the structure of the Act to say that the measure of the tax is the extent of the interest of both joint tenants is, in effect, to say that a tax will be laid on the interest of Cornelia in respect of which Jonas had in his lifetime no longer either title or control." The court rejected that conclusion and denied to the Acts of Congress retroactive operation. To this the Circuit Court of Appeals was opposed and reversed the judgment based upon it.

**487** It will be observed, therefore, that this case involves the same question as that decided in *Shwab v. Doyle* [¶425], and on the authority of that case the judgment of the Circuit Court of Appeals is reversed and the cause remanded for further proceedings in accordance with this opinion.

*So ordered.*



# UNINDEXED SUPPLEMENTARY ESTATE TAX REGULATIONS, ETC.

(Decision.)

Revenue Act of 1918.—Equally applicable to the 1921 Act.  
January 8, 1923.

For the purposes of the deduction on account of charitable bequests, the amount of "bequests to charity" out of the residuary estate, is the amount of the residuary estate after state transfer or succession taxes have been paid therefrom by the terms of the will, without further reduction by the amount of the Federal Estate Tax on the net estate though such tax in fact does reduce by its amount the residuary estate passing to charity.

UNITED STATES CIRCUIT COURT OF APPEALS  
FOR THE SECOND CIRCUIT.

William H. Edwards, formerly Collector of Internal Revenue for the  
Second District of New York,  
Plaintiff-in-error,  
Defendant below,

vs.

Joseph Jermain Slocum, Herbert Jermain Slocum. Stephen L'Hommedieu  
Slocum, Robert W. de Forest and Henry W. de Forest, as  
Executors of the last Will and Testament of  
Margaret Olivia Sage, deceased,  
Defendants-in-error,  
Plaintiffs below.

*Writ of error to judgment entered in the District Court for the  
Southern District of New York.*

**488** Action was brought by defendants-in-error as Executors, etc., of  
**298** Mrs. Sage, to recover part of the estate tax assessed against them as  
such executors, and paid under protest to the defendant who at the  
time was a Collector of Internal Revenue.

**489** Mrs. Sage died November 4, 1918, a resident of New York, and by her  
will disposed of her estate in a manner sufficiently set forth as follows:

(1) The usual provision as to payment of debts; (2) certain pecuniary  
and specific legacies with directions that some should be paid free of all  
legacy or inheritance taxes; (3) the residue to be divided into a certain  
number of equal parts, and each part given to a named educational,  
religious or charitable corporation.

**490** This estate was subject to the estate tax established by Revenue  
Act of 1916 (39 Stat., 756) Sec. 201, reading:

"That a tax \* \* \* equal to the following percentages of the  
value of the net estate, to be determined as provided in section two  
hundred and three, is hereby imposed upon the transfer of the net  
estate of every decedent dying after the passage of this Act, whether a  
resident or non-resident of the United States: \* \* \*."

**491** The phrase "gross estate" is defined by Sec. 202 as follows:

"That the value of the gross estate of the decedent shall be determined  
by including the value at the time of his death of all property, real or  
personal, tangible or intangible, wherever situated."

## UNINDEXED SUPPLEMENTARY ESTATE TAX REGULATIONS, ETC.

**492** Sec. 203 treats of "net estate" thus:

"That for the purpose of the tax the net estate shall be determined—

(a) In the case of a resident by deducting from the value of the gross estate—

(1) Such amounts for funeral expenses, administration expenses, claims against the estate, unpaid mortgages, losses incurred during the settlement of the estate arising from fires, storms, shipwreck, or other casualty, and from theft, when such losses are not compensated for by insurance or otherwise, support during the settlement of the estate of those dependent upon the decedent, and such other charges against the estate as are allowed by the laws of the jurisdiction, whether within or without the United States, under which the estate is being administered; and

(2) An exemption of \$50,000."

**493** The Revenue Act of 1918 (40 Stat., 1057) added, and made retro-active so as to include this estate a third item of deduction, viz.:

"The amount of all bequests \* \* \* to or for the use of any corporation organized and operated exclusively for religious, charitable \* \* \* or educational purposes," etc.

**494** Disregarding all inheritance, legacy, transfer or estate taxes, the facts about the property passing under this will were as follows:

Debts and expenses.....	\$3,789,321.74
Pecuniary legacies for charitable, etc., purposes.....	1,285,000.00
Pecuniary legacies for non-charitable purposes.....	8,618,079.55
Residuary estate, to charitable, etc., purposes.....	35,436,855.70

Gross..... \$49,129,256.99

**495** The New York Inheritance tax on such legacies as the will declared free of tax, was \$5,741.83. Plaintiff executors stated the return for United States estate tax thus:

Gross..... \$49,129,256.99

*Deductions:*

(1) Debts, &c..... \$3,789,321.74

(2) Charitable, etc., legacies other than residual..... 1,285,000.00

(3) Residuary for charity, etc..... 35,436,855.70

(4) Specific exemption..... 50,000.00

40,561,177.44

Net estate..... \$8,568,079.55

**496** The above shows that what was offered for tax, i. e., the "net estate," is exactly the aggregate of pecuniary bequests to other than charitable, &c., purposes—less the specific statutory exemption. The proper tax on this net figure is admittedly \$1,406,977.50.**497** To this the Commissioner objected, and restated the return by adopting all the executors' figures except those for the "Residuary for charity, etc." which he reduced to \$33,610,506.75, thereby increasing the "Net estate" by the amount of the reduction; and on investigation this difference is found to be exactly the total of the estate tax assessed, viz..... \$1,820,607.12

And the New York Inheritance tax above mentioned,

viz..... 5,741.83

Or..... \$1,826,348.95



**498** This result, which plainly involves paying an estate tax on the amount of the tax paid, was reached in a manner to be treated in our opinion. The executors sued after protest, and the trial Court gave judgment [¶306] on demurrer for all taxes over what they admitted as *per* their return, except that on or measured by the \$5,741.83 of State tax. The Collector then brought this writ.

Richard S. Holmes, Special Assistant U. S. Attorney, for plaintiff-in-error;  
Robert Thorne, for defendants-in-error;  
Sullivan & Cromwell by permission filed brief as *amici curiae*.

**499** HOUGH, C. J.—That this is not an inheritance or legacy tax, that it is not payable by legatees or out of legacies as such, and that it is a tax payable out of and on the estate, and by the executors, is agreed (*Matter of Hamlin*, 226 N. Y., 407), and no complaint is now made as to including in whatever is taxed or measures tax the New York inheritance taxes (*New York, etc. Co. vs. Eisner*, 256 U. S., 345 [¶397 herein]).

**E500** Taxes, however, are not laid on abstractions, names do not change facts, and every tax ultimately falls on some person, unless it be laid upon a thing without an owner, which is rare.

**E501** So far as the words of this statute are concerned, the United States does not care who ultimately bears the weight of this tax; it announces the sum and demands payment from the executors; if the legatees and devisees cannot agree as to the burden bearing, the state courts can settle the matter. The New York courts have settled it, so far as this estate is concerned, by the Hamlin case (*supra*); and this tax is payable out of the whole estate as a paramount charge, which in effect casts it on, or takes it out of the residuary. That the residuary estate is devoted to charity, &c., makes no difference.

**E502** We impute no motives, but it seems as if this New York rule were the suggestion for the method of tax laying here insisted on by the Treasury.

**E503** The train of reasoning is that there cannot be a residuary estate until paramount charges are paid, therefore the true residuary is approximately what in the absence of any tax would be residuum—less the tax itself; but since such an amount of money cannot be left untaxed, or otherwise at large, it must go somewhere else, and the natural place to go is the net estate. It is urged insistently that since the residuary charities will not get what the United States takes, and would get that much more if the United States took nothing—what they do not get must be taxable, and since that which is taxable or measures tax is called “net estate” by the statute, there it must go.

**E504** Assuming this as truth, the tax-layer perceives that the “net estate,” which is practically synonymous with taxable estate, is to receive augmentation by an unknown amount, which renders its own figure unknown; but this baffles arithmetic, so he has recourse to an algebraic formula, which has played an unduly important part in the arguments at bar.

**E505** We have treated this formula in a footnote\*, it is only legally important in that it has produced the argument that any method of

\*Let G=Gross estate, *i. e.*, the amount above given.

A=Sum of debts, expenses, non-residuary legacies to charity, etc., and statutory



taxation or of working out taxes that requires so much algebra "must be wrong." We need not go so far, but do hold that the presumption is that Congress intended a simpler method—one that a plain man could understand. Algebraic formulae are not lightly to be imputed to legislators.

**E506** It is next observable that this using of tax to measure tax will only happen when the residuary estate or some part of it is devoted to charity or other deductible purpose. If this testatrix had made her charitable bequests before inserting a residuary clause, no difficulty would have arisen. It is argued with apparent seriousness that this is "something for which the testatrix is responsible," which is true only if the law laid such a trap as this for charitable residuary legatees as distinguished from equally charitable general legatees—again something not lightly imputable to the lawgiver.

**E507** But all states do not treat the incidence of the tax as does New York; and if distributees were ratably assessed by the tribunal of administration to pay the estate tax, or if all estate taxes were treated as "a charge against the estate"—the reasoning by which this tax is supported would fail. The result would be confusion, again something not be imputed to the act if it can be avoided.

**E508** If the statutory language is considered with some attention to legal history, the phrase "net estate" is not new but very old. It conveys the plain meaning of what is left as available for instant use, it is the clear or clean estate, a synonym unusually suggestive of the original French word. The net estate resulting from the legal invention of using a tax to measure a tax does not respond to that concept, it is but a fiction, never to be found except in a tax sheet. This is artificial, not real, and is to be avoided if at all possible.

**E509** Again, observing the language of the statute, it may be admitted that net estate is used but as a measure for tax, and is not itself taxed; for the impost is said to fall upon the entire property. This is mere matter of words; for practical purposes the net estate is the taxable estate.

**E510** It is therefore a fundamental objection not only as to the spirit but the letter of this act, that the taxable estate is augmented by a deliberate and designed encroachment upon charities.

exemption, *i. e.*, \$5,124,321.74.

S = Aggregate of all non-residuary legacies, debts, expenses and State Inheritance taxes on "free of tax" legacies; *i. e.*, \$13,698,143.12.

K = Total tax on all blocks up the one last used—assumed to be \$1,722,000.

B = Total of blocks on which the tax is K; assumed to be \$10,000,000.

% = Rate of tax on last block—assumed as 25%.

N = Net estate, R = Residue and T = Estate tax, all three assumed as unknown.

Then  $G = R - S - T$

$T = K - \% (N - B)$

$N = G - (A - R)$

From these three equations, by a cumbrous system of substitutions, is evolved the final formula-equation, viz.:

$$75\% \text{ of } R - G - S - K - \% G - \% A - \% B$$

The assumed unknown R is now expressed in terms of known quantities, and can be translated into figures; and this done, satisfaction of the equations first stated follows:

This sounds impressive, but it all starts from the assumption that B equals \$10,000,000; for that implies that N, which of course includes B, is over that sum. But the only possible reason for asserting N to be more than ten millions is to observe that the obvious tax measure *i. e.*, the sum of non-charitable legacies, plus the admitted tax is nearly ten million.

But neither N nor B can possibly be ten million, unless the tax *pro tanto* measures itself. Thus the mathematician has assumed the whole legal question; has assumed as law that the tax is measured by an entity which includes the tax. The formula is only useful in reaping the fruits of this assumption concerning the law.

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**E511** It is the intent of the statute that charitable bequests shall not be taxed. By its regulation of the incidence of the tax, New York does in fact diminish in favor of the United States what the charities receive; but it must be wrong for the executive departments of the United States to use the rule of incidence, which is of state creation, to increase its own exactions.

**E512** As Holmes, J. remarked in the New York Trust Co. case, *supra*, "Upon this point a page of history is worth a volume of logic." History, so far as we can discover, shows no other instance of attempting to measure a tax *pro tanto* by itself. As Hand, J., said in the court below, this theory departs from long established practice and from the usage if not the law of never regarding the incidence of a tax in the levying of a tax.

**E513** So far as authority goes, *Dugan vs. Miles*, 276 Fed., 401, is the only decision suggested on this branch of the statute. The facts in that litigation were legally identical with those at bar; yet it is true that the doctrine here contended for by the Treasury was not alluded to by the experienced and able Judge who wrote opinion, although his result is consistent only with the methods pursued by these defendants-in-error. The inference is that neither the Judge nor counsel on either side thought of such a theory—which does not seem to us surprising.

**E514** Being of opinion, therefore, that the scheme of taxation insisted on by plaintiff-in-error is unjust, opposed to long-established practice and the spirit of the statute, that it is not required by the language of the act, and tends to confusion taking the country over—the judgment below [¶306] should be and is affirmed, with costs.

[Petition for writ of certiorari granted by U. S. Supreme Court, May 7, 1923, in the case reported above.]

(T. D. 3487.)

**E515 Estate Tax—Reservation of Powers.**—Article 21 of Regulations 63, 125 and Article 25 of Regulations 37 [1918 Act], are hereby amended to read as follows:

**"Reservation of powers.**—Where a transfer by trust or otherwise is subject to revocation by the donor, or the terms thereof may be altered or amended by him, or he reserves to himself the right to take or assume either full or partial control of the transferred property, or to direct or control the management thereof, all facts and circumstances bearing upon the donor's intent are to be considered, and if it appears that he intended the transfer to take effect in possession or enjoyment at or after his death, then the value of the transferred property should be included in the gross estate, unless it further appears that the transfer was a bona fide sale for a fair consideration in money or money's worth." (T. D. 3487, signed by Commissioner D. H. Blair, and dated June 6, 1923.)



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 UNINDEXED SUPPLEMENTARY ESTATE TAX REGULATIONS, ETC.
 

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(Decision.)

1916-1917 Acts.

July 3, 1923.

Maryland collateral inheritance tax attaches to an estate before distribution and hence the amount thereof was deductible.

UNITED STATES CIRCUIT COURT OF APPEALS  
FOURTH CIRCUIT.

JOSHUA W. MILES, former collector of Internal Revenue for the United States in and for the District of Maryland and Delaware, Plaintiff in Error,

*versus*

JOHN J. CURLEY, JOHN M. DENNIS and WILLIAM A. DIXON, Executors of the last Will and Testament of HELEN M. H. GRAFFLIN, late of Baltimore County, Deceased,  
Defendants in Error.

*In Error to the District Court of the United States for the District of Maryland at Baltimore.*

Before WOODS and WADDILL, CIRCUIT JUDGES, and McCLINTIC, District Judge

A. W. W. WOODCOCK, U. S. Attorney and H. M. DARLING, Special Attorney, Bureau of Internal Revenue, (NELSON T. HARTSON, Solicitor of Internal Revenue, on brief) for Plaintiff in Error, and J. WALLACE BRYAN (CHARLES McHENRY HOWARD and JOSEPH C. FRANCE on brief) for Defendants in Error.

**E516** McCLINTIC, District Judge: The defendants in error, (hereinafter 156 called the plaintiffs) brought an action at law in the District Court of Maryland to recover a certain sum of money paid to the Collector of Internal Revenue for the District of Maryland and Delaware, being the amount of certain Federal estate taxes assessed by the collector on the estate of Helen M. H. Grafflin, who died a resident of Maryland, which sum was claimed by the plaintiffs to be in excess of the amount lawfully chargeable thereon. Such sum of money had been paid under protest, and all proper steps had been taken to bring such action for the recovery thereof.

**E517** The taxes were assessed and collected by such collector (hereafter called the defendant) under the provisions of the Act of Congress approved September 8, 1916, as amended by the Act approved March 3, 1917.

**E518** The executors claimed a deduction from the total taxable estate of \$48,759.44 paid to the State of Maryland as an estate tax. The collector claimed that the deduction was not proper because the tax under the laws of Maryland was a legacy tax.

**E519** The defendant interposed a demurrer to the declaration which was overruled.

**E520** By stipulation, it was agreed that there was no dispute as to the facts alleged in the declaration, and the court being of opinion that the law was with the plaintiffs, a final judgment was entered therein on the 26th



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day of April, 1922, for the plaintiffs, and against the defendant, for the sum of \$3,710.25, and \$26.05 costs.

**E521** There is but one question in this case, and that is, does the Maryland collateral inheritance tax attach to an estate before distribution? If so, the plaintiffs are entitled to recover the amount above named.

"*Lederer vs. Northern Trust Co.*, 262 Fed. 52; 253 U. S. 487."

**E522** If, on the other hand, the Maryland tax is a legacy tax, and not an estate tax, the sum in controversy was properly collected.

"*New York Trust Co. vs. Eisner*, 256 U. S. 345 [¶397 herein]".

**E523** The decision by the highest court of Maryland, directly deciding this question, and construing the statute imposing such collateral inheritance tax, would be binding upon this court. Is there any such decision?

**E524** In discussing this question, the learned district judge, in his opinion overruling the demurrer to the declaration herein says:

"In the case at bar, each side has argued that the Court of Appeals of this State has interpreted the act in the sense for which it contends, and each quotes language which, if standing alone, might sustain its position. That each is able to do so is perhaps the best proof that the attention of that high court never had been drawn to the precise point now at issue, in such sense, at least, as to call for its definite determination."

**E525** We have examined the cases decided by the Court of Appeals of Maryland, and referred to in the briefs of counsel, and have reached the conclusion that no decision upon this point has been really made.

**E526** The Pennsylvania statute upon the subject of collateral inheritance tax, is believed to be the first that was passed by any state in America. This statute was enacted in 1826.

**E527** In 1884, the legislature of the State of Maryland, in substance and effect adopted the Pennsylvania statute.

**E528** In the case of *Jackson vs. Myers*, 257 Pa. 104, the Supreme Court of Pennsylvania decided that the collateral inheritance tax of Pennsylvania is not levied upon the inheritance or legacy, but upon the estate of the decedent, holding that what passes to the legatee is simply the portion of the estate remaining, after the State has been satisfied by receiving the tax.

**E529** An examination of other cases in that State shows, that this case only follows the previous holdings on this subject.

**E530** The question presented herein, for decision, was directly presented to the Circuit Court of Appeals of the third circuit, in the case of *Lederer vs. Northern Trust Company*, *supra*, and that case held, that under the Pennsylvania statute, and the decisions of the court of last resort in the State of Pennsylvania, such tax was an estate tax, and not a legacy tax, and that the plaintiff therein should recover from the collector, the amount so paid under protest.

**E531** Upon the authority of that case, and under all the circumstances and conditions surrounding this case, we hold that the proper construction of the collateral inheritance statute of Maryland, makes such tax an estate tax, and not a legacy tax, and, therefore, the judgment below, is

*Affirmed.*

[The foregoing decision has been published by the Government as T. D. 3514, dated September 7, 1923.—The Corporation Trust Company.]

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(T. D. 3513.)

**E532** Receipt of Liberty bonds, Treasury bonds and Treasury notes in payment estate taxes.—The appended department circular [¶E533 to 358 E535], issued under date of July 31, 1923, with reference to receipt of Treasury bonds of the United States in payment of Federal estate and inheritance taxes, is published for the information of internal-revenue officers and others concerned. This circular supplements Department Circular No. 225, dated January 31, 1921 (T. D. 3144) [¶358], as supplemented by Department Circular dated June 30, 1922, (T. D. 3383) [¶388]. (T. D. 3513, signed by Commissioner D. H. Blair, and dated September 7, 1923.)

## Second Supplement to Department Circular No. 225.

(Appended to T. D. 3513, ¶E532, above.)

**E533** 1. The provisions of Department Circular No. 225, dated January 31, 1921, as supplemented June 30, 1922, prescribing regulations governing the receipt of bonds and notes of the United States for Federal estate or inheritance taxes are hereby extended and made applicable to Treasury bonds of the United States now or hereafter issued under authority of the Act of Congress approved September 24, 1917, as amended, bearing interest at a higher rate than 4 per centum per annum, and any such Treasury bonds shall accordingly be receivable by the United States at par and accrued interest in payment of any estate or inheritance taxes imposed by the United States, under or by virtue of any present or future law, upon the same terms and conditions as provided in said Department Circular No. 225, dated January 31, 1921, with respect to the acceptance of bonds and notes bearing interest at a higher rate than 4 per centum per annum.

**E534** 2. The bonds and notes at this date outstanding, bearing interest 359 at a higher rate than 4 per centum per annum, which come within the provisions of Department Circular No. 225, dated January 31, 1921, as thus supplemented, are:

Description	Date of issue	Short Title
(a) First Liberty Loan Converted $4\frac{1}{4}$ per cent bonds of 1932-47.....	May 9, 1918	First $4\frac{1}{4}$ 's
(b) First Liberty Loan Second Converted $4\frac{1}{4}$ s per cent bonds of 1932-47.....	Oct. 24, 1918	First Second $4\frac{1}{4}$ 's
(c) Second Liberty Loan Converted $4\frac{1}{4}$ per cent bonds of 1927-42.....	May 9, 1918	Second $4\frac{1}{4}$ 's
(d) Third Liberty Loan $4\frac{1}{4}$ per cent bonds of 1928	do	Third $4\frac{1}{4}$ 's
(e) Fourth Liberty Loan $4\frac{1}{4}$ per cent bonds of 1933-38.....	Oct. 24, 1918	Fourth $4\frac{1}{4}$ 's
(f) $4\frac{1}{4}$ per cent Treasury bonds of 1947-52.....	Oct. 16, 1922	Treasury bonds of 1947-52
(g) $5\frac{3}{4}$ per cent notes, payable June 15, 1924.....	June 15, 1921	Series A-1924
(h) $5\frac{1}{2}$ per cent notes, payable September 15, 1924	Sept. 15, 1921	Series B-1924
(i) $4\frac{3}{4}$ per cent notes, payable March 15, 1925....	Feb. 1, 1922	Series A-1925
(j) $4\frac{3}{4}$ per cent notes, payable March 15, 1926....	Mar. 15, 1922	Series A-1926
(k) $4\frac{3}{8}$ per cent notes, payable December 15, 1925	June 15, 1922	Series B-1925
(l) $4\frac{1}{4}$ per cent notes, payable September 15, 1926	Aug. 1, 1922	Series B-1926
(m) $4\frac{1}{2}$ per cent notes, payable June 15, 1925....	Dec. 15, 1922	Series C-1925
(n) $4\frac{1}{2}$ per cent notes, payable December 15, 1927	Jan. 15, 1923	Series A-1927
(o) $4\frac{3}{4}$ per cent notes, payable March 15, 1927....	May 15, 1923	Series B-1927



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**E535** 3. For the calculation of accrued interest on the current coupons of bonds and notes tendered in payment of estate or inheritance taxes under this circular, the method outlined in Exhibit B [¶383] to Department Circular No. 225, dated January 31, 1921, should be followed. Interest tables at the various rates borne by the various issues, or for other or future issues, may be obtained from the Treasury Department, Division of Loans and Currency, Washington, upon request. (Second Supplement to Department Circular No. 225 appended to T. D. 3513, ¶E532, signed by S. P. Gilbert, Jr., Acting Secretary of the Treasury, and dated July 31, 1923.)

**E536** California Community Property (1916-1917 Acts).—The California  
117 Supreme Court holds, no question of Federal taxation being involved,  
127 however, in *Roberts vs. Wehmeyer* (August 17, 1923), that the  
285 husband is the owner of the community property. Judge Lawlor in  
the course of his opinion states that "we are not unmindful of the  
two decisions rendered in the case of *Blum vs. Wardell*, one by the United  
States District Court, 270 Fed. 309, and the other by the United States Circuit  
Court of Appeals, 276 Fed. 226," holding that the wife's half of the  
community property should not be included in the decedent husband's gross  
estate for the purposes of the Federal estate tax (1916 Act). Judge Lawlor,  
continuing, says: "We agree with the decision of the Circuit Court of Appeals  
in so far as it is based on the interpretation of the Inheritance Tax Act of  
1917 (California) to the effect that the part of the community property  
passing to the wife should not be subject to such tax."—The Corporation Trust  
Company.

**E537** Deductibility of New York State transfer (inheritance) tax as "a  
262 charge against the estate;" bequest or devise in lieu of dower: 1916  
Act.—[In the United States Supreme Court on October 8, 1923, *Title  
Guarantee and Trust Company vs. Edwards*, No. 46, October 1923 Term  
(below, 290 Fed. 617, ¶262 herein), was dismissed "for want of jurisdiction,"  
citing *Farrell vs. O'Brien* (199 U. S. 89, 100), *Toop vs. Ulysses Land Company*  
(237 U. S. 580), and *Piedmont Power and Light Company vs. Town of  
Graham* (253 U. S. 193, 195). Per curiam.—The Corporation Trust Company.]



(T. D. 3524.)

**E538** Property passing under general power of appointment to be included in gross estate of the one exercising the power; Decision of Court, 1918 Act.—The decision of the United States District Court for the Eastern District of Pennsylvania in the case of The Pennsylvania Company for Insurances on Lives and Granting Annuities, and Catherine M. Colfelt-Taylor, Executors of the Estate of Rebecca Colfelt, deceased, v. Ephraim Lederer, Collector of Internal Revenue of the First District of Pennsylvania, the syllabus of which appears below [¶E539 to E542] is published not as a ruling of the Treasury Department, but for the information of internal revenue officers and others concerned.

[The syllabus referred to in ¶E538 above, follows.]

**E539** 1. *Gross Estate—Power of Appointment.*—Section 402 (e) of the Revenue Act of 1918 provides that property passing under a general power of appointment shall be included in the gross estate of a decedent. Under the Law of Pennsylvania the appointee of a power takes under the will of the donor and not under the will of the donee of the power. Where a general power of appointment is exercised by a decedent the value of the appointed property should be included in the decedent's gross estate regardless of the fact that the appointees and their respective interests in the appointed property are the same as would have been the case had the power not been exercised.

**E540** 2. *Estate Tax—Measure—Statutory Construction.*—The will of Congress to tax must be found expressed in the language of the Act interpreted in the light of the situation presented to the legislature. The estate tax levied by the Revenue Act of 1918 measures the tax by the gross value of all the property of a decedent which passed by will plus the value of all property which passed in practical effect by the same will, although it passed not by virtue of dominion over property but by virtue of a power of appointment.

**E541** 3. *Estate Tax—Excise Tax.*—The estate tax is an excise tax levied upon the privilege enjoyed by one who makes disposition of property to take effect at his death and the measure is wholly within the control of Congress.

**E542** 4. *Constitutionality.*—Legislation is not unconstitutional in the legal sense unless the legislation be in conflict with a provision of our written Constitution and Acts of Congress are not unconstitutional merely because unwise or in conflict with sound principles of legislation. Under this rule Section 402 (e) of the Revenue Act of 1918 is constitutional.

(T. D. 3524, signed by Acting Commissioner C. R. Nash, and dated October 8, 1923.)

(T. D. 3529.)

**E543** Estate of decedent dying during 1918 is taxable, and so is taxable  
59 under the 1916-1917 Acts.—**Court decision.**—The decision of the United States District Court for the District of Colorado in the case of Louise B. Page v. Skinner, Collector, August 6, 1923, the syllabus of which appears below [¶E544 and ¶E545] is published not as a ruling of the Treasury Department, but for the information of internal revenue officers and others concerned.

[The syllabus referred to in ¶E543 above, follows.]

**E544** 1. *Estate Tax—Effect of Repeal.*—Where a decedent died on September 4, 1918, the Federal Estate tax should be computed at the rates provided by the Revenue Act of 1916 as amended by the Act of March 3, 1917 and the Revenue Act of 1917.

**E545** 2. *Estate Tax—Effect of Repeal.*—Section 1400 (b) of the Revenue Act of 1918 does not repeal the Revenue Act of 1916 as amended by the Act of March 3, 1917, or the Revenue Act of 1917 as to the imposition of an Estate tax on the estates of decedents dying prior to the passage of the Revenue Act of 1918. The Revenue Act of 1916 as amended by the Act of March 3, 1917 and the Revenue Act of 1917 impose a tax which impresses itself on the Estate of a decedent dying prior to the Revenue Act of 1918, and the liability thus imposed is saved by Section 13 of the Revised Statutes [general saving clause]. (T. D. 3529, signed by Acting Commissioner C. R. Nash, and dated November 10, 1923.)

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Under the 1917 Act - Court decision. The decision of the United States Supreme Court in the District of Columbia is the case of *United States v. Egan*, 235 U.S. 189, 1915. The decision is a landmark case in the history of the Federal Government's power to regulate interstate commerce. It is a landmark case in the history of the Federal Government's power to regulate interstate commerce. It is a landmark case in the history of the Federal Government's power to regulate interstate commerce.

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**For the excess-profits tax law for 1921 see page 401.**

¶1000 (instead of ¶500) is shown on the yellow Excess Profits Tax guide card on the left because all new pages having bold face paragraph numbers sent to be inserted in this Excess-Profits Tax division will bear paragraph numbers in the 1000 series.

## WAR-PROFITS AND EXCESS-PROFITS TAXES.

As the occasions will be many during 1923 when the necessity will arise to refer to the exact language of the excess-profits tax provisions of the Revenue Acts of 1918 and 1921, and to the official regulations and rulings based specifically thereon, we republish these herein.

The provisions of the Revenue Act of 1918 relating to the excess-profits tax, and the formal regulations bearing thereon, are reproduced on the pages immediately following. The caption to each page shows distinctly that the 1918 Act is involved.

The provisions of the Revenue Act of 1921 relating to the excess-profits tax for 1921 are reproduced beginning on page 401, following the Supplementary Bulletin Rulings. There too will be found the formal regulations relating specifically to the 1921 Act, as well as current Treasury Decisions, etc., etc.

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## WAR-PROFITS AND EXCESS-PROFITS TAX FOR 1918, 1919, and 1920.

BEING TITLE III OF THE REVENUE ACT OF 1918.

*[For the law imposing a war-profits and excess-profits tax for the calendar year 1921 see beginning on page 401, immediately following the Supplementary Bulletin Rulings.]*



[The captions and other matters in [brackets] are ours.]

### TITLE III.—WAR-PROFITS AND EXCESS-PROFITS TAX REVENUE ACT OF 1918.

#### PART I.—General Definitions.

500 Sec. 300 [of the Revenue Act of 1918 of which this Title is a  
597 part]. That when used in this title the terms [see definitions below] "taxable year," "fiscal year," "personal service corporation," "paid or accrued," and "dividends" shall have the same meaning as provided for the purposes of income tax in sections 200 and 201. The first taxable year for the purposes of this title shall be the same as the first taxable year for the purposes of the income tax under Title II.

[Definitions of terms, extracted from Titles I and II.]

["Taxable year" and "Fiscal year".]

501 The term "taxable year" means the calendar year, or the fiscal year ending during such calendar year, upon the basis of which the net income is computed under section 212 or section 232. The term "fiscal year" means an accounting period of twelve months ending on the last day of any month other than December. The first taxable year, to be called the taxable year 1918, shall be the calendar year 1918 or any fiscal year ending during the calendar year 1918;

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[“Personal Service Corporation.”]

- 502** The term “personal service corporation” means a corporation  
**656** whose income is to be ascribed primarily to the activities of the principal owners or stockholders who are themselves regularly engaged in the active conduct of the affairs of the corporation and in which capital (whether invested or borrowed) is not a material income-producing factor; but does not include any foreign corporation, nor any corporation 50 per centum or more of whose gross income consists either (1) of gains, profits or income derived from trading as a principal, or (2) of gains, profits, commissions, or other income, derived from a Government contract or contracts made between April 6, 1917, and November 11, 1918, both dates inclusive;

[“Government Contracts.”]

- 503** The term “Government contract” means (a) a contract  
**605** made with the United States, or with any department, bureau, officer, commission, board, or agency, under the United States and acting in its behalf, or with any agency controlled by any of the above if the contract is for the benefit of the United States, or (b) a subcontract made with a contractor performing such a contract if the products or services to be furnished under the subcontract are for the benefit of the United States. The term “Government contract or contracts made between April 6, 1917, and November 11, 1918, both dates inclusive” when applied to a contract of the kind referred to in clause (a) of this paragraph, includes all such contracts which, although entered into during such period, were originally not enforceable, but which have been or may become enforceable by reason of subsequent validation in pursuance of law;

[“Paid or incurred” and “Paid or accrued”.]

- 504** The term “paid,” for the purposes of the deductions and credits under this title, means “paid or accrued” or “paid or incurred,” and the terms “paid or incurred” and “paid or accrued” shall be construed according to the method of accounting upon the basis of which the net income is computed under section 212.

[Dividends.]

- 505** Sec. 201. (a) That the term “dividend” when used in this title (except in paragraph (10) of subdivision (a) of section 234) means (1) any distribution made by a corporation, other than a personal service corporation, to its shareholders or members, whether in cash or in other property [or in stock of the corporation], out of its earnings or profits accumulated since February 28, 1913, or (2) any such distribution made by a personal service corporation out of its earnings or profits accumulated since February 28, 1913, and prior to January 1, 1918.
- 506** (b) Any distribution shall be deemed to have been made from earnings or profits unless all earnings and profits have first been distributed. Any distribution made in the year 1918 or any



year thereafter shall be deemed to have been made from earnings or profits accumulated since February 28, 1913, or, in the case of a personal service corporation, from the most recently accumulated earnings or profits; but any earnings or profits accumulated prior to March 1, 1913, may be distributed in stock dividends or otherwise, exempt from the tax, after the earnings and profits accumulated since February 28, 1913, have been distributed.

(c) [A dividend paid in stock of the corporation shall be considered income to the amount of the earnings or profits distributed.] Amounts distributed in the liquidation of a corporation shall be treated as payments in exchange for stock or shares, and any gain or profit realized thereby shall be taxed to the distributee as other gains or profits.

(d) If any stock dividend (1) is received by a taxpayer between January 1 and November 1, 1918, both dates inclusive, or (2) is during such period bona fide authorized or declared, and entered on the books of the corporation, and is received by a taxpayer after November 1, 1918, and before the expiration of thirty days after passage of this Act, then such dividend shall, in the manner provided in section 206, be taxed to the recipient at the rates prescribed by law for the years in which the corporation accumulated the earnings or profits from which such dividend was paid, but the dividend shall be deemed to have been paid from the most recently accumulated earnings or profits.]

(e) Any distribution made during the first sixty days of any taxable year shall be deemed to have been made from earnings or profits accumulated during preceding taxable years; but any distribution made during the remainder of the taxable year shall be deemed to have been made from earnings or profits accumulated between the close of the preceding taxable year and the date of distribution, to the extent of such earnings or profits, and if the books of the corporation do not show the amount of such earnings or profits, the earnings or profits for the accounting period within which the distribution was made shall be paid from the most recently accumulated earnings or profits.

## PART II.—Imposition of Tax.

Sec. 301. (a) That in lieu of the tax imposed by Title II of the Revenue Act of 1917, but in addition to the other taxes imposed by this Act, there shall be levied, collected, and paid for the taxable year 1918 upon the net income of every corporation a tax equal to the sum of the following:

### First Bracket.

30 per centum of the amount of the net income in excess of the excess-profits credit (determined under section 312) and not in excess of 20 per centum of the invested capital;

### Second Bracket.

65 per centum of the amount of the net income in excess of 20 per centum of the invested capital;



## Third Bracket.

**513** The sum, if any, by which 80 per centum of the amount of the net income in excess of the war-profits credit (determined under section 311) exceeds the amount of the tax computed under the first and second brackets.

**514** (b) For the taxable year 1919 and each taxable year thereafter  
**603** there shall be levied, collected, and paid upon the net income of every corporation (except corporations taxable under subdivision (c) of this section) a tax equal to the sum of the following:

## First Bracket.

**515** 20 per centum of the amount of the net income in excess of the excess-profits credit (determined under section 312) and not in excess of 20 per centum of the invested capital;

## Second Bracket.

**516** 40 per centum of the amount of the net income in excess of 20 per centum of the invested capital.

**517** (c) For the taxable year 1919 and each taxable year thereafter  
**604** there shall be levied, collected, and paid upon the net income of  
**626** every corporation which derives in such year a net income of more than \$10,000 from any Government contract or contracts made between April 6, 1917, and November 11, 1918, both dates inclusive, a tax equal to the sum of the following:

**518** (1) Such a portion of a tax computed at the rates specified in subdivision (a) as the part of the net income attributable to such Government contract or contracts bears to the entire net income. In computing such tax the excess-profits credit and the war-profits credit applicable to the taxable year shall be used;

**519** (2) Such a portion of a tax computed at the rates specified in subdivision (b) as the part of the net income not attributable to such Government contract or contracts bears to the entire net income.

**520** For the purpose of determining the part of the net income  
**607** attributable to such Government contract or contracts, the proper apportionment and allocation of the deductions with respect to gross income derived from such Government contract or contracts and from other sources, respectively, shall be determined under rules and regulations prescribed by the Commissioner with the approval of the Secretary.

**521** (d) In any case where the full amount of the excess-profit  
**621** credit is not allowed under the first bracket of subdivision (a) or (b), by reason of the fact that such credit is in excess of 20 per centum of the invested capital, the part not so allowed shall be deducted from the amount in the second bracket.

**522** (e) For the purposes of the Act approved March 21, 1918, entitled "An Act to provide for the operation of transportation systems while under Federal control, for the just compensation of their owners, and for other purposes," the tax imposed by this title shall be treated as levied by an Act in amendment of Title II of the Revenue Act of 1917.

## [Maximum Tax Limitation.]

**523**    Sec. 302. That the tax imposed by subdivision (a) of section  
**639**    301 shall in no case be more than 30 per centum of the amount of the net income in excess of \$3,000 and not in excess of \$20,000, plus 80 per centum of the amount of the net income in excess of \$20,000; the tax imposed by subdivision (b) of section 301 shall in no case be more than 20 per centum of the amount of the net income in excess of \$3,000 and not in excess of \$20,000, plus 40 per centum of the amount of the net income in excess of \$20,000; and the above limitations shall apply to the taxes computed under subdivisions (a) and (b) of section 301, respectively, when used in subdivision (c) of that section. Nothing in this section shall be construed in such manner as to increase the tax imposed by section 301.

## [Partial Personal Service Corporations.]

**524**    Sec. 303. That if part of the net income of a corporation is  
**645**    derived (1) from a trade or business (or a branch of a trade or business) in which the employment of capital is necessary, and (2) a part (constituting not less than 30 per centum of its total net income) is derived from a separate trade or business (or a distinctly separate branch of the trade or business) which if constituting the sole trade or business would bring it within the class of "personal service corporations [¶ 502]", then (under regulations prescribed by the Commissioner with the approval of the Secretary) the tax upon the first part of such net income shall be separately computed (allowing in such computation only the same proportionate part of the credits authorized in sections 311 and 312), and the tax upon the second part shall be the same percentage thereof as the tax so computed upon the first part is of such first part: Provided, That the tax upon such second part shall in no case be less than 20 per centum thereof, unless the tax upon the entire net income, if computed without benefit of this section, would constitute less than 20 per centum of such entire net income, in which event the tax shall be determined upon the entire net income, without reference to this section, as other taxes are determined under this title. The total tax computed under this section shall be subject to the limitations provided in section 302.

## [Exempt Corporations.]

**525**    Sec. 304. (a) That the corporations enumerated in section 231  
**666**    [¶667] shall, to the extent that they are exempt from income tax under Title II, be exempt from taxation under this title.

**526**    (b) Any corporation whose net income for the taxable year is  
**666**    less than \$3,000 shall be exempt from taxation under this title.

**527**    (c) In the case of any corporation engaged in the mining  
**682**    of gold, the portion of the net income derived from the mining of gold shall be exempt from the tax imposed by this title, and the tax on the remaining portion of the net income shall be the proportion of a tax computed without the benefit of this sub-



division which such remaining portion of the net income bears to the entire net income.

[Specific Exemption in relation to tax for less than 12 months.]

- 528** Sec. 305. That if a tax is computed under this title for a  
**634** period of less than twelve months, the specific exemption of  
**684** \$3,000, wherever referred to in this title, shall be reduced to an amount which is the same proportion of \$3,000 as the number of months in the period is of twelve months.

### PART III.—Credits.

- 529** Sec. 310. That as used in this title the term "prewar period"  
**685** means the calendar years 1911, 1912, and 1913, or, if a corporation was not in existence during the whole of such period, then as many of such years during the whole of which the corporation was in existence.

[The War-Profits Credit.]

- 530** Sec. 311. (a) That the war-profits credit shall consist of the  
**686** sum of:  
**531** (1) A specific exemption of \$3,000; and  
**532** (2) An amount equal to the average net income of the corporation for the prewar period, plus or minus, as the case may be, 10 per centum of the difference between the average invested capital for the prewar period and the invested capital for the taxable year. If the tax is computed for a period of less than  
**634** twelve months such amount shall be reduced to the same proportion thereof as the number of months in the period is of twelve months.

[No income for the prewar period.]

- 533** (b) If the corporation had no net income for the prewar period,  
**688** or if the amount computed under paragraph (2) of subdivision (a) is less than 10 per centum of its invested capital for the taxable year, then the war-profits credit shall be the sum of:  
**534** (1) A specific exemption of \$3,000; and  
**535** (2) An amount equal to 10 per centum of the invested capital for the taxable year.

[Not in existence in Prewar Period.]

- 536** (c) If the corporation was not in existence during the whole  
**690** of at least one calendar year during the prewar period, then, except as provided in subdivision (d), the war-profits credit shall be the sum of:  
**537** (1) A specific exemption of \$3,000; and  
**538** (2) An amount equal to the same percentage of the invested  
**694** capital of the taxpayer for the taxable year as the average percentage of net income to invested capital, for the prewar period, of corporations engaged in a trade or business of the same general class as that conducted by the taxpayer; but such amount



shall in no case be less than 10 per centum of the invested capital of the taxpayer for the taxable year. Such average percentage shall be determined by the Commissioner on the basis of data contained in returns made under Title II of the Revenue Act of 1917, and the average known as the median shall be used. If such average percentage has not been determined and published at least 30 days prior to the time when the return of the taxpayer is due, then for purposes of such return 10 per centum shall be used in lieu thereof; but such average percentage when determined shall be used for the purposes of section 250 [payment of the tax] in determining the correct amount of the tax.

(d) The war-profits credit shall be determined in the manner provided in subdivision (b) instead of in the manner provided in subdivision (c), in the case of any corporation which was not in existence during the whole of at least one calendar year during the prewar period, if (1) a majority of its stock at any time during the taxable year is owned or controlled, directly or indirectly, by a corporation which was in existence during the whole of at least one calendar year during the prewar period, or if (2) 50 per centum or more of its gross income (as computed under section 233 for income tax purposes) consists of gains, profits, commissions, or other income, derived from a government contract or contracts made between April 6, 1917, and November 11, 1918, both dates inclusive.

(e) A foreign corporation shall not be entitled to a specific exemption of \$3,000. [See Sec. 327, ¶565, and Sec. 328, ¶570, of the law.]

#### [The Excess-Profits Credit.]

Sec. 312. That the excess-profits credit shall consist of a specific exemption of \$3,000 plus an amount equal to 8 per centum of the invested capital for the taxable year.

A foreign corporation shall not be entitled to the specific exemption of \$3,000. [See Sec. 327, ¶565, and Sec. 328, ¶570, of the law.]

#### PART IV.—Net Income.

Sec. 320. (a) That for the purpose of this title the net income of a corporation shall be ascertained and returned—

(1) For the calendar years 1911 and 1912 upon the same basis and in the same manner as provided in section 38 of the Act entitled "An Act to provide revenue, equalize duties, and encourage the industries of the United States, and for other purposes," approved August 5, 1909, except that taxes imposed by such section and paid by the corporation within the year shall be included;

(2) For the calendar year 1913 upon the same basis and in the same manner as provided in Section II of the Act entitled "An Act to reduce tariff duties and to provide revenue for the Government, and for other purposes," approved October 3, 1913, except that taxes imposed by section 38 of such Act of August 5, 1909, and paid by the corporation within the year shall be

included, and except that the amounts received by it as dividends upon the stock or from the net earnings of other corporations subject to the tax imposed by Section II of such Act of October 3, 1913, shall be deducted; and

546 (3) For the taxable year upon the same basis and in the same manner as provided for income tax purposes in Title II of this Act.

547 (b) The average net income for the prewar period shall be  
687 determined by dividing the number of years within that period during the whole of which the corporation was in existence into the sum of the net income for such years, even though there may have been no net income for one or more of such years.

## PART V.—Invested Capital.

### [Definitions.]

548 Sec. 325. (a) That as used in this title—

549 The term “intangible property” means patents, copyrights,  
738 secret processes and formulae, good will, trade-marks, trade-brands, franchises, and other like property;

550 The term “tangible property” means stocks, bonds, notes, and  
738 other evidences of indebtedness, bills and accounts receivable, leaseholds, and other property other than intangible property;

551 The term “borrowed capital” means money or other property  
739 borrowed, whether represented by bonds, notes, open accounts, or otherwise;

552 The term “inadmissible assets” means stocks, bonds, and other  
743 obligations (other than obligations of the United States), the dividends or interest from which is not included in computing net income, but where the income derived from such assets consists in part of gain or profit derived from the sale or other disposition thereof, or where all or part of the interest derived from such assets is in effect included in the net income because of the limitation on the deduction of interest under paragraph (2) of subdivision (a) of section 234, a corresponding part of the capital invested in such assets shall not be deemed to be inadmissible assets;

553 The term “admissible assets” means all assets other than inadmissible assets, valued in accordance with the provisions of subdivision (a) of section 326, section 330, and section 331.

554 (b) For the purposes of this title, the par value of stock or shares shall, in the case of stock or shares issued at a nominal value or having no par value, be deemed to be the fair market value as of the date or dates of issue of such stock or shares.

### [Computing “Invested Capital.”]

555 Sec. 326. (a) That as used in this title the term “invested  
751 capital” for any year means (except as provided in subdivisions  
820 (b) and (c) of this section):

556 (1) Actual cash bona fide paid in for stock or shares;

753

815



**557** (2) Actual cash value of tangible property, other than cash,  
**754** bona fide paid in for stock or shares, at the time of such pay-  
 ment, but in no case to exceed the par value of the original  
 stock or shares specifically issued therefor, unless the actual  
 cash value of such tangible property at the time paid in is shown  
 to the satisfaction of the Commissioner to have been clearly and  
 substantially in excess of such par value, in which case such  
 excess shall be treated as paid-in surplus: Provided, That the  
 Commissioner shall keep a record of all cases in which tangible  
 property is included in invested capital at a value in excess of  
 the stock or shares issued therefor, containing the name and  
 address of each taxpayer, the business in which engaged, the  
 amount of invested capital and net income shown by the return,  
 the value of the tangible property at the time paid in, the par  
 value of the stock or shares specifically issued therefor, and the  
 amount included under this paragraph as paid-in surplus. The  
 Commissioner shall furnish a copy of such record and other  
 detailed information with respect to such cases when required  
 by resolution of either House of Congress, without regard to the  
 restrictions contained in section 257;

**558** (3) Paid-in or earned surplus and undivided profits; not in-  
**760** cluding surplus and undivided profits earned during the year;  
**810**

**559** (4) Intangible property bona fide paid in for stock or shares  
**804** prior to March 3, 1917, in an amount not exceeding (a) the  
 actual cash value of such property at the time paid in, (b) the  
 par value of the stock or shares issued therefor, or (c) in the  
 aggregate 25 per centum of the par value of the total stock or  
 shares of the corporation outstanding on March 3, 1917, which-  
 ever is lowest;

**560** (5) Intangible property bona fide paid in for stock or shares  
**804** on or after March 3, 1917, in an amount not exceeding (a) the  
 actual cash value of such property at the time paid in, (b) the  
 par value of the stock or shares issued therefor, or (c) in the  
 aggregate 25 per centum of the par value of the total stock  
 or shares of the corporation outstanding at the beginning of the  
 taxable year, whichever is lowest: Provided, That in no case  
 shall the total amount included under paragraphs (4) and (5)  
 exceed in the aggregate 25 per centum of the par value of the  
 total stock or shares of the corporation outstanding at the begin-  
 ning of the taxable year; but

**561** (b) As used in this title the term "invested capital" does not  
**739** include borrowed capital.

**562** (c) There shall be deducted from invested capital as above  
**805** defined a percentage thereof equal to the percentage which the  
 amount of inadmissible assets is of the amount of admissible  
 and inadmissible assets held during the taxable year.

**563** (d) The invested capital for any period shall be the average  
**634** invested capital for such period, but in the case of a corpora-  
**806** tion making a return for a fractional part of a year, it shall  
 (except for the purpose of paragraph (2) of subdivision (a)  
 of section 311) be the same fractional part of such average  
 invested capital.



**564** The average invested capital for the prewar period shall  
**687** be determined by dividing the number of years within that period during the whole of which the corporation was in existence into the sum of the average invested capital for such years.

[Special cases subject to special tax.]

**585** Sec. 327. That in the following cases the tax shall be deter-  
**831** mined as provided in section 328:

**586** (a) Where the Commissioner is unable to determine the in-  
vested capital as provided in section 326;

**587** (b) In the case of a foreign corporation [see §§830 and §852];

**588** (c) Where a mixed aggregate of tangible property and in-  
**756** tangible property has been paid in for stock or for stock and bonds and the Commissioner is unable satisfactorily to determine the respective values of the several classes of property at the time of payment, or to distinguish the classes of property paid in for stock and for bonds, respectively;

**589** (d) Where upon application by the corporation the Commis-  
**831** sioner finds and so declares of record that the tax if determined without benefit of this section would, owing to abnormal conditions affecting the capital or income of the corporation, work upon the corporation an exceptional hardship evidenced by gross disproportion between the tax computed without benefit of this section and the tax computed by reference to the representative corporations specified in section 328. This subdivision shall not apply to any case (1) in which the tax (computed without benefit of this section) is high merely because the corporation earned within the taxable year a high rate of profit upon a normal invested capital, nor (2) in which 50 per centum or more of the gross income of the corporation for the taxable year (computed under section 233 of Title II) consists of gains, profits, commissions, or other income, derived on a cost-plus basis from a Government contract or contracts made between April 6, 1917, and November 11, 1918, both dates inclusive.

[The special tax applicable to the special cases.]

**570** Sec. 328. (a) In the cases specified in section 327 the tax shall  
**832** be the amount which bears the same ratio to the net income of the taxpayer (in excess of the specific exemption of \$3,000) for the taxable year, as the average tax of representative corporations engaged in a like or similar trade or business, bears to their average net income (in excess of the specific exemption of \$3,000) for such year. In the case of a foreign corporation the tax shall be computed without deducting the specific exemption of \$3,000 either for the taxpayer or the representative corporations.

**571** In computing the tax under this section the Commissioner  
**832** shall compare the taxpayer only with representative corporations whose invested capital can be satisfactorily determined under section 326 and which are, as nearly as may be, similarly circumstanced with respect to gross income, net income, profits per unit of business transacted and capital employed, the amount

and rate of war profits or excess profits, and all other relevant facts and circumstances.

**572** (b) For the purposes of subdivision (a) the ratios between  
**832** the average tax and the average net income of representative corporations shall be determined by the Commissioner in accordance with regulations prescribed by him with the approval of the Secretary.

**573** In cases in which the tax is to be computed under this section,  
**833** if the tax as computed without the benefit of this section is less than 50 per centum of the net income of the taxpayer, the installments shall in the first instance be computed upon the basis of such tax; but if the tax so computed is 50 per centum or more of the net income, the installments shall in the first instance be computed upon the basis of a tax equal to 50 per centum of the net income. In any case, the actual ratio when ascertained shall be used in determining the correct amount of the tax. If the correct amount of the tax when determined exceeds 50 per centum of the net income, any excess of the correct installments over the amounts actually paid shall on notice and demand be paid together with interest at the rate of  $\frac{1}{2}$  of 1 per centum per month on such excess from the time the installment was due.

**574** (c) The Commissioner shall keep a record of all cases in  
**832** which the tax is determined in the manner prescribed in subdivision (a), containing the name and address of each taxpayer, the business in which engaged, the amount of invested capital and net income shown by the return, and the amount of invested capital as determined under such subdivision. The Commissioner shall furnish a copy of such record and other detailed information with respect to such cases when required by resolution of either House of Congress, without regard to the restrictions contained in section 257 [contents of returns not to be disclosed].

## PART VI.—Reorganizations.

### [Reorganizations after January 1, 1911.]

**575** Sec. 330. That in the case of the reorganization, consolida-  
**837** tion, or change of ownership after January 1, 1911, of a trade or business now carried on by a corporation, the corporation shall for the purposes of this title be deemed to have been in existence prior to that date, and the net income and invested capital of such predecessor trade or business for all or any part of the prewar period prior to the organization of the corporation now carrying on such trade or business shall be deemed to have been the net income and invested capital of such corporation.

**576** If such predecessor trade or business was carried on by a  
**838** partnership or individual the net income for the prewar period shall, under regulations prescribed by the Commissioner with the approval of the Secretary, be ascertained and returned as nearly as may be upon the same basis and in the same manner as provided for corporations in Title II, including a reasonable deduction for salary or compensation to each partner or the individual for personal services actually rendered.



[Incorporating prior to July 1, 1919, business of an individual or of a partnership.]

**577** In the case of the organization as a corporation before July 1,  
**839** 1919, of any trade or business in which capital is a material income-producing factor and which was previously owned by a partnership or individual, the net income of such trade or business from January 1, 1918, to the date of such reorganization may at the option of the individual or partnership be taxed as the net income of a corporation is taxed under Titles II and III; in which event the net income and invested capital of such trade or business shall be computed as if such corporation had been in existence on and after January 1, 1918, and the undistributed profits or earnings of such trade or business shall not be subject to the surtax imposed in section 211, but amounts distributed on or after January 1, 1918, from the earnings of such trade or business shall be taxed to the recipients as dividends, and all the provisions of Titles II and III relating to corporations shall so far as practicable apply to such trade or business: Provided, That this paragraph shall not apply to any trade or business the net income of which for the taxable year 1918 was less than 20 per centum of its invested capital for such year: Provided further, That any taxpayer who takes advantage of this paragraph shall pay the tax imposed by section 1000 of this Act [§3000] and by the first subdivision of section 407 of the Revenue Act of 1916, as if such taxpayer had been a corporation on and after January 1, 1918, with a capital stock having no par value.

**578** If any asset of the trade or business in existence both during the  
**340** taxable year and any prewar year is included in the invested capital for the taxable year but is not included in the invested capital for such prewar year, or is valued on a different basis in computing the invested capital for the taxable year and such prewar year, respectively, then under rules and regulations to be prescribed by the Commissioner with the approval of the Secretary such readjustments shall be made as are necessary to place the computation of the invested capital for such prewar year on the basis employed in determining the invested capital for the taxable year.

[Reorganizations after March 3, 1917.]

**579** **Sec. 331.** In the case of the reorganization, consolidation, or  
**841** change of ownership of a trade or business, or change of ownership of property, after March 3, 1917, if an interest or control in such trade or business or property of 50 per centum or more remains in the same persons, or any of them, then no asset transferred or received from the previous owner shall, for the purpose of determining invested capital, be allowed a greater value than would have been allowed under this title in computing the invested capital of such previous owner if such asset had not been so transferred or received: Provided, That if such previous owner was not a corporation, then the value of any asset so transferred or received shall be taken at its cost of acquisition (at the date when acquired by such previous owner)

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with proper allowance for depreciation, impairment, betterment or development, but no addition to the original cost shall be made for any charge or expenditure deducted as expense or otherwise on or after March 1, 1918, in computing the net income of such previous owner for purposes of taxation.

## PART VII.—Miscellaneous.

### [Returns on fiscal year basis.]

**580**    **842**    Sec. 335. (a) That if a corporation (other than a personal service corporation) makes return for a fiscal year beginning in 1917 and ending in 1918, the tax for the first taxable year under this title shall be the sum of: (1) the same proportion of a tax for the entire period computed under Title II of the Revenue Act of 1917 which the portion of such period falling within the calendar year 1917 is of the entire period, and (2) the same proportion of a tax for the entire period computed under this title at the rates specified in subdivision (a) of section 301 which the portion of such period falling within the calendar year 1918 is of the entire period.

**581**    Any amount heretofore or hereafter paid on account of the **844** tax imposed for such fiscal year by Title II of the Revenue Act of 1917 shall be credited toward the payment of the tax imposed for such fiscal year by this title, and if the amount so paid exceeds the amount of the tax imposed by this title, the excess shall be credited or refunded to the corporation in accordance with the provisions of section 252.

**582**    (b) If a corporation makes return for a fiscal year beginning **845** in 1918 and ending in 1919, the tax for such fiscal year under this title shall be the sum of: (1) the same proportion of a tax for the entire period computed under subdivision (a) of section 301 which the portion of such period falling within the calendar year 1918 is of the entire period, and (2) the same proportion of a tax for the entire period computed under subdivision (b) or (c) of section 301 which the portion of such period falling within the calendar year 1919 is of the entire period.

**583**    (c) If a partnership or a personal service corporation makes **842** return for a fiscal year beginning in 1917 and ending in 1918, it shall pay the same proportion of a tax for the entire period computed under Title II of the Revenue Act of 1917 which the portion of such period falling within the calendar year 1917 is of the entire period.

**584**    Any tax paid by a partnership or personal service corporation for any period beginning on or after January 1, 1918, shall be immediately refunded to the partnership or corporation as a tax erroneously or illegally collected.

### [Returns and payment of taxes.]

**588**    **849**    Sec. 336. That every corporation, not exempt under section 304, shall make a return for the purposes of this title. Such returns shall be made, and the taxes imposed by this title shall be paid, at the same times and places, in the same manner, and subject to the same conditions, as is provided in the case of returns

and payment of income tax by corporations for the purposes of Title II, and all the provisions of that title not inapplicable, including penalties, are hereby made applicable to the taxes imposed by this title.

[Sale of mines, oil or gas wells.]

**586**      Sec. 337. That in the case of a bona fide sale of mines, oil or  
**853**      gas wells, or any interest therein, where the principal value of the property has been demonstrated by prospecting or exploration and discovery work done by the taxpayer, the portion of the tax imposed by this title attributable to such sale shall not exceed 20 per centum of the selling price of such property or interest.

[Consolidated Returns.]

**587**      Sec. 240 [of Title II of the Revenue Act of 1918, of which  
**734**      the War-Profits and Excess-Profits Tax is Title III]. (a) That corporations which are affiliated within the meaning of this section shall, under regulations to be prescribed by the Commissioner with the approval of the Secretary, make a consolidated return of net income and invested capital for the purposes of this title and Title III, and the taxes thereunder shall be computed and determined upon the basis of such return: Provided, That there shall be taken out of such consolidated net income and invested capital, the net income and invested capital of any such affiliated corporation organized after August 1, 1914, and not successor to a then existing business, 50 per centum or more of whose gross income consists of gains, profits, commissions, or other income, derived from a Government contract or contracts made between April 6, 1917, and November 11, 1918, both dates inclusive. In such case the corporation so taken out shall be separately assessed on the basis of its own invested capital and net income and the remainder of such affiliated group shall be assessed on the basis of the remaining consolidated invested capital and net income.

**588**      In any case in which a tax is assessed upon the basis of a  
**723**      consolidated return, the total tax shall be computed in the first instance as a unit and shall then be assessed upon the respective affiliated corporations in such proportions as may be agreed upon among them, or, in the absence of any such agreement, then on the basis of the net income properly assignable to each. There shall be allowed in computing the income tax only one specific credit of \$2,000 (as provided in section 236); in computing the war-profits credit (as provided in section 311) only one specific exemption of \$3,000; and in computing the excess-profits credit (as provided in section 312) only one specific exemption of \$3,000.

**589**      (b) For the purpose of this section two or more domestic corporations shall be deemed to be affiliated (1) if one corporation owns directly or controls through closely affiliated interests or by a nominee or nominees substantially all the stock of the other or others, or (2) if substantially all the stock of two or more corporations is owned or controlled by the same interests.



**590** (c) For the purposes of section 238 a domestic corporation which owns a majority of the voting stock of a foreign corporation shall be deemed to have paid the same proportion of any income, war-profits and excess-profits taxes paid (but not including taxes accrued) by such foreign corporation during the taxable year to any foreign country or to any possession of the United States upon income derived from sources without the United States, which the amount of any dividends (not deductible under section 234) received by such domestic corporation from such foreign corporation during the taxable year bears to the total taxable income of such foreign corporation upon or with respect to which such taxes were paid: Provided, That in no such case shall the amount of the credit for such taxes exceed the amount of such dividends (not deductible under section 234) received by such domestic corporation during the taxable year.

**591 to 595** Blank.

**596** For ¶596 see page 318.



# OFFICIAL RULINGS, REGULATIONS, OPINIONS, AND DECISIONS UNDER THE

## WAR-PROFITS AND EXCESS-PROFITS TAX LAW—1918 ACT

Including

All of Regulations 45, Revised, Part II-B, 1920 Edition,

As amended

Relating specifically to

The War-Profits and Excess-Profits Tax Law—1918 Act,

Together with

Numerous explanatory special rulings.

REGULATIONS 45, PART II-B Rev., (1920 Edition), promulgated January 28, 1921,

As amended.

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**596 Important Comment.**—Appended to each paragraph or unit of paragraphs in the compilation, beginning at ¶597 below, is a citation showing the official source and date. Without exception the Articles of Regulations 45, Revised, referring specifically to the excess-profits tax law, that is, the 7-hundred (701), the 8-hundred (801) and the 9-hundred (901) series, are printed in regular numerical order. Thus any particular Article may be located without difficulty. The fact that there are missing Article numbers (as Art. 702 to 710) in the 7-, 8-, and 9-hundred series, indicates with certainty that on December 15, 1922, there were no Articles bearing such missing number designations. Attention is called to the purely supplementary Bureau Rulings, reproduced hereinafter in full, as originally issued by the Government, on the pages following immediately after the blue excess-profits tax index opposite page 400. *The reader is earnestly cautioned to read the foreword to these Bureau Rulings*

## GENERAL DEFINITIONS.

§300

**597 Art. 701. War Profits and Excess Profits Tax.**—The war profits and excess profits tax, like the income tax, is a tax upon net income. It applies only to corporations. See section 301 of the statute and articles 711-720 [¶598]. The terms "taxable year," "fiscal year," "personal service corporation," "paid or accrued," and "dividends," and in general all other terms used in connection with the income tax, have here the same meaning as provided for the purposes of the income tax. See sections 1, 200, and 201 and articles 1501-1510, 1523-1533 and 1541-1549 [for terms, beginning at ¶501, and ¶8099]. For other terms see sections 310 [¶529] and 325 [¶555] and articles 771 [¶685] and 811-818 [beginning at ¶738]. (Art. 701, Reg. 45, Rev., Jan. 28, 1921.)

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WAR TAX 318 SERVICE



## IMPOSITION OF TAX.

§301

**598** Art. 711. Imposition of tax.—The tax is imposed upon the net  
 510 income of every corporation, domestic or foreign, except personal  
 service corporations and certain other classes of corporations. See  
 section 304 of the statute and articles 751-753 [for exempt corporations,  
 ¶666]. Special provisions of the statute deal with corporations deriving  
 net income from Government contracts (*see section 1* [¶503 for law and  
 ¶604 for regulations]), transportation corporations (*see article 504* [¶599  
 below]), corporations partly partaking of the nature of personal service  
 corporations (*see section 303* [¶524 for law and ¶645 for regulations;]),  
 corporations engaged in the mining of gold (*see section 304* [¶527 for law  
 and ¶682 for regulations]), foreign and abnormal corporations (*see section*  
 327 [¶565 for law and ¶831 for regulations]), reorganized and consolidated  
 corporations (*see sections 330 and 331* [¶575 to ¶579 for law and ¶837 for  
 regulations]), corporations making their returns upon the basis of a fiscal  
 year (*see section 335* [¶580 for law and ¶842 for regulations]), and corporations  
 which have sold mines or oil or gas wells (*see section 337* [¶586 for law and  
 ¶853 for regulations]). For the requirements as to rendering returns *see*  
 section 336 [¶585 for law, and ¶849 for regulations]. (Art. 711, Reg. 45,  
 Rev., Jan. 28, 1921.)

**599 to 601 Blank.**

**602** Art. 712. Computation of war-profits and excess-profits tax for 1918.

514 —For the taxable year 1918, (a) if the net income, as defined in sec-  
 tion 320 (a) (3) of the statute, is not in excess of 20 per cent of the  
 invested capital, as defined in section 326, then under the first bracket the  
 tax is 30 per cent of the amount of the net income in excess of the excess  
 profits credit, as defined in section 312, and the second bracket is not applic-  
 able. (b) If the net income is in excess of 20 per cent of the invested capital,  
 then under the first bracket the tax is 30 per cent of the excess of an amount  
 of net income equal to 20 per cent of the invested capital over the excess  
 profits credit, and under the second bracket the tax is 65 per cent of the  
 amount of the remaining net income less any excess profits credit not ex-  
 hausted under the first bracket. (c) If the tax under (a) or the aggregate  
 tax under (b) equals or exceeds 80 per cent of the amount of the net income  
 in excess of the war profits credit, as defined in section 311, then the tax  
 under (a) or (b) is the amount of the tax payable. But if such tax is less  
 than such 80 per cent, then the tax payable is 80 per cent of the amount of  
 the net income in excess of the war profits credit. But *see section 302 and*  
*articles 731-733* [for maximum limitation of tax beginning at ¶639]. (Art.  
 712, Reg. 45, Rev., Jan. 28, 1921.)

**603** Art. 713. Computation of excess-profits tax for 1919 and thereafter.

510 —For the taxable year 1919 and subsequent years, (a) if the net  
 income, as defined in section 320 (a) (3) [¶546] of the statute, is not  
 in excess of 20 per cent of the invested capital, as defined in section 326  
 [¶555], then under the first bracket the tax payable is 20 per cent of the  
 amount of the net income in excess of the excess profits credit, as defined  
 in section 312 [¶541], and the second bracket is not applicable. (b) If the net  
 income is in excess of 20 per cent of the invested capital, then under the first  
 bracket the tax is 20 per cent of the excess of an amount of net income equal

to 20 per cent of the invested capital over the excess profits credit, and under the second bracket the tax is 40 per cent of the amount of the remaining net income less any excess profits credit not exhausted under the first bracket. The sum of the taxes computed under the two brackets is the tax payable. But see the following article [for war-profits tax for 1919 and subsequent taxable years in certain instances, ¶604] and section 302 [for maximum limitation of tax: law ¶523 and regulations ¶641]. (Art. 713, Reg. 45, Rev., Jan. 28, 1921.)

**604** Art. 714. Computation of tax on income from Government contracts.—In the case of a corporation which derives in any taxable year after 1918 a net income of more than \$10,000 from any Government contracts made after April 5, 1917, and before November 12, 1918, the tax shall be such a proportion of a tax computed at the rates for 1918 as the portion of the net income attributable to the Government contracts bears to the entire net income, plus such a proportion of a tax computed at the rates for 1919 as the amount of the remaining net income bears to the entire net income. In computing such taxes, however, the excess profits credit and the war profits credit applicable to the taxable year shall be used. [For example of computation of tax see ¶626.] But see section 302 of the statute [for maximum tax limitation, ¶523; regulations ¶639]. The part of the net income attributable to such Government contracts shall be determined in accordance with the following article. See also section 1 [law ¶503] and article 1510. (Art. 714, Reg. 45, Rev., Jan. 28, 1921.)

**605 and 606** Blank.

**607** Art. 715. Allocation of Net Income to Particular Source.—When-  
520 ever it is necessary to determine the portion of the net income derived from or attributable to a particular source, the corporation shall allocate to the gross income derived from such source, and to the gross income derived from each other source, the expenses, losses, and other deductions properly appertaining thereto, and shall apply any general expenses, losses, and deductions (which can not properly be otherwise apportioned) ratably to the gross income from all sources. The gross income derived from a particular source, less the deductions properly appertaining thereto and less its proportion of any general deductions, shall be the net income derived from such source. The corporation shall submit with its return a statement fully explaining the manner in which such expenses, losses, and deductions were allocated or distributed. (Art. 715, Reg. 45, Rev., Jan. 28, 1921.)

**608** Art. 716. Illustration of Computation of Tax.—A corporation has an average prewar invested capital of \$50,000, an average prewar net income of \$10,000, an invested capital for 1918 of \$100,000, a net income for 1918 of \$40,000, an invested capital for 1919 of \$110,000, and a net income of \$50,000.

**609** (1) For 1918 the excess profits credit is a specific exemption of \$3,000, plus 8 per cent of the invested capital (i. e., 8 per cent of \$100,000) or \$8,000, making a total of \$11,000. See section 312 of the statute and article 791 [for excess profits credit, ¶724]. The war profits



credit is a specific exemption of \$3,000, plus the average prewar net income or \$10,000, plus or minus 10 per cent of the difference between the average prewar invested capital and the invested capital for 1918. In this case it is plus, because the invested capital for 1918 is greater than the average prewar invested capital. The amount added is 10 per cent of the difference between \$100,000 and \$50,000, i. e., 10 per cent of \$50,000, or \$5,000, making a total war profits credit of \$18,000. See section 311 and article 781 [for war profits credit, ¶686].

**610** *First bracket.*—The amount or portion of the net income (\$40,000) in excess of the excess profits credit (\$11,000) and not in excess of 20 per cent of the invested capital (i. e., 20 per cent of \$100,000) or \$20,000 is \$9,000. The tax computed under this bracket is 30 per cent of this amount (i. e., 30 per cent of \$9,000) or \$2,700.

**611** *Second bracket.*—The amount or portion of the net income (\$40,000) in excess of 20 per cent of the invested capital (i. e., 20 per cent of \$100,000) or \$20,000 is \$20,000. The tax computed under this bracket is 65 per cent of this amount (i. e., 65 per cent of \$20,000) or \$13,000.

**612** *Third bracket.*—Eighty per cent of the amount or portion of the net income in excess of the war profits credit (i. e., 80 per cent of the amount by which \$40,000 exceeds \$18,000, or \$22,000) is \$17,600. The amount of the tax computed under the first and second brackets (\$2,700 plus \$13,000) is \$15,700. The tax computed under this bracket is the amount by which \$17,600 exceeds \$15,700, or \$1,900.

**613** *Total tax.*—The total tax for 1918 is the sum of the taxes computed under the three brackets (i. e., \$2,700 plus \$13,000 plus \$1,900) or \$17,600.

**614** (2) For 1919 the excess profits credit is a specific exemption of \$3,000 plus 8 per cent of the invested capital (i. e., 8 per cent of \$110,000) or \$8,800, a total of \$11,800. See section 312 and article 791 [for excess profits credit, ¶724].

**615** *First bracket.*—The amount or portion of the net income (\$50,000) in excess of the excess profits credit (\$11,800) and not in excess of 20 per cent of the invested capital (i. e., 20 per cent of \$110,000) or \$22,000 is \$10,200. The tax computed under this bracket is 20 per cent of this amount (i. e., 20 per cent of \$10,200) or \$2,040.

**616** *Second bracket.*—The amount or portion of the net income (\$50,000) in excess of 20 per cent of the invested capital (i. e., 20 per cent of \$110,000) or \$22,000 is \$28,000. The tax computed under this bracket is 40 per cent of this amount (i. e., 40 per cent of \$28,000) or \$11,200.

**617** *Total tax.*—The total tax for 1919 is the sum of the taxes computed under the two brackets (i. e., \$2,040 plus \$11,200) or \$13,240. (Art. 716, Reg. 45, Rev., Jan. 28, 1921.)



**618** *Art. 717. Illustration of computation where no tax under third bracket.*—If the corporation used as an illustration in Article 716 [¶608] had an average prewar net income of \$20,000 instead of \$10,000, the excess profits credit and the tax for 1918 computed under the first and second brackets would be the same, but the war profits credit and the tax computed under the third bracket would not be the same. The war profits credit would be a specific exemption of \$3,000 plus the average prewar net income, or \$20,000, plus 10 per cent of \$50,000 (the difference in invested capital) or \$5,000, making a total war profits credit of \$28,000.

**619** *Third bracket.*—Eighty per cent of the amount of the net income in excess of the war profits credit (i. e., 80 per cent of the amount by which \$40,000 exceeds \$28,000 or 80 per cent of \$12,000) is \$9,600. The amount of the tax computed under the first and second brackets (\$2,700 plus \$13,000) is \$15,700. There is accordingly no tax under the third bracket, as \$9,600 does not exceed \$15,700.

**620** *Total tax.*—The total tax for 1918 is the sum of the taxes computed under the three brackets (i. e., \$2,700 plus \$13,000 plus nothing) or \$15,700. The total tax for 1919 would, of course, be the same as in article 716 [¶608]. (Art. 717, Reg. 45, Rev., Jan. 28, 1921.)

**621** *Art. 718. Illustration of Computation where Excess Profits Credit not Exhausted under First Bracket.*—A corporation has an average prewar invested capital of \$20,000, an average prewar net income of \$7,000, and invested capital and net income for 1918 of the same amounts, respectively. The excess profits credit is a specific exemption of \$3,000 plus 8 per cent of the invested capital (i. e., 8 per cent of \$20,000) or \$1,600, a total of \$4,600. The war profits credit is a specific exemption of \$3,000 plus the average prewar net income of \$7,000, a total of \$10,000. There is nothing further to be added or deducted in this case, as there is no difference between the average invested capital for the prewar period and the invested capital for the taxable year.

**622** *First bracket.*—The excess profits credit (\$4,600) exceeds 20 per cent of the invested capital (20 per cent of \$20,000) or \$4,000, and there is no amount taxable under this bracket.

**623** *Second bracket.*—The portion of the net income (\$7,000) in excess of 20 per cent of the invested capital (20 per cent of \$20,000) or \$4,000 is \$3,000. In this case, however, the full amount of the excess profits credit could not be allowed under the first bracket, so that the \$3,000 which would ordinarily be taxable under this bracket is reduced by the amount of the excess profits credit not allowed under the first bracket (\$600), leaving only \$2,400 taxable under this bracket. The tax computed under this bracket is 65 per cent of this amount (i. e., 65 per cent of \$2,400) or \$1,560.

**624** *Third bracket.*—The war profits credit (\$10,000) exceeds the net income (\$7,000), so that there is no tax under this bracket.

**625** *Total tax.*—The total tax for 1918 would be the sum of the taxes computed under the three brackets (i. e., nothing plus \$1,560 plus nothing) or \$1,560, were it not that section 302 [¶523] provides that the

maximum tax shall not in this case exceed \$1,200. See articles 731-733 [for maximum tax limitation, ¶639]. The total tax for 1918 is therefore \$1,200. (Art. 718, Reg. 45, Rev., Jan. 28, 1921.)

**626** Art. 719. Illustration of Computation where Net Income Derived  
**517** from Government Contract.—If in the case of the corporation used as an illustration in article 716 [¶608] the \$50,000 net income for 1919 includes \$20,000 of net income from Government contracts, the tax for that year would be the sum of the amounts computed under clauses (1) and (2) of section 301 (c) of the statute [¶517].

**627** (1) Under clause (1) the excess profits credit is \$11,800, the same as under clause (2). The war profits credit is a specific exemption of \$3,000, plus the average prewar net income, or \$10,000, plus 10 per cent of \$60,000 (the difference in invested capital) or \$6,000, making a total war profits credit of \$19,000.

**628** *First bracket.*—The amount or portion of the net income (\$50,000) in excess of the excess profits credit (\$11,800) and not in excess of 20 per cent of the invested capital (i. e., 20 per cent of \$110,000), or \$22,000, is \$10,200. The tax computed under this bracket is 30 per cent of this amount (i. e., 30 per cent of \$10,200) or \$3,060.

**629** *Second bracket.*—The amount or portion of the net income (\$50,000) in excess of 20 per cent of the invested capital (i. e., 20 per cent of \$110,000) or \$22,000, is \$28,000. The tax computed under this bracket is 65 per cent of this amount (65 per cent of \$28,000) or \$18,200.

**630** *Third bracket.*—Eighty per cent of the amount of the net income in excess of the war profits credit (i. e., 80 per cent of the amount by which \$50,000 exceeds \$19,000, or \$31,000) is \$24,800. The amount of the tax computed under the first and second brackets (\$3,060 plus \$18,200) is \$21,260. The tax computed under this bracket is the amount by which \$24,800 exceeds \$21,260, or \$3,540.

**631** The portion of the tax computed under clause (1) is the same proportion of the total amount computed under the above brackets at the rates for 1918 (i. e., \$3,060 plus \$18,200 plus \$3,540) or \$24,800, as the part of the net income attributable to Government contracts (\$20,000) is of the entire net income (\$50,000). This portion of the tax is therefore  $\frac{2}{5}$  of \$24,800, or \$9,920.

**632** (2) The portion of the tax computed under clause (2) is the same proportion of the total amount computed at the rates for 1919 or \$13,240 (for the details see illustration for 1919 under article 716) as the part of the net income not attributable to Government contracts (\$30,000) is of the entire net income (\$50,000). This portion of the tax is therefore  $\frac{3}{5}$  of \$13,240 or \$7,944.

**633** (3) The total tax for the year 1919 is the sum of the amounts computed under paragraphs (1) and (2) above (\$9,920 plus \$7,944) or \$17,864. (Art. 719, Reg. 45, Rev., Jan. 28, 1921.)



**634** Art. 720. Illustration of computation where return for period of less than 12 months.—A corporation which has reported on the basis of the fiscal year ending March 31, 1918, later changes to a calendar year basis and files a return covering the 9 months from April 1, 1918, to December 31, 1918. It had an average prewar capital of \$50,000, an average prewar net income of \$3,500, an invested capital for the 9 months ending December 31, 1918, of \$120,000, and a net income for such period of \$50,000. It should be noted that this is a somewhat different method of arriving at the same result which would be reached under a literal application of sections 305, 311 (a) (2) and 326 (d) of the statute. The excess profits credit is computed by adding the specific exemption of \$3,000 to 8 per cent of the full invested capital of \$120,000, or \$9,600, a total of \$12,600, and taking 9/12 of this result, or \$9,450, as the excess profits credit. The war profits credit is computed by adding the specific exemption of \$3,000 to 10 per cent of the full invested capital of \$120,000, or \$12,000, a total of \$15,000, and taking 9/12 of this result, or \$11,250, as the war profits credit. The war profits credit is computed in this case under section 311 (b), because the amount computed under section 311 (a) (2) is less than 10 per cent of the invested capital. The amount computed under section 311 (a) (2) would be the sum of the average prewar net income, or \$3,500, plus 10 per cent of the amount by which the full invested capital of \$120,000 actually used during the taxable period exceeds the average prewar invested capital of \$50,000 (i.e., 10 per cent of \$70,000), or \$7,000, a total of \$10,500. This amount is less than 10 per cent of the full invested capital for the taxable year as computed under section 311 (b).

**635** First bracket.—The amount or portion of the net income (\$50,000) in excess of the excess profits credit (\$9,450) and not in excess of 9/12 of 20 per cent of the invested capital (i. e., 9/12 of 20 per cent of \$120,000), or \$18,000, is \$8,550. The tax computed under this bracket is 30 per cent of this amount (i. e., 30 per cent of \$8,550), or \$2,565.

**636** Second bracket.—The amount or portion of the net income (\$50,000) in excess of 9/12 of 20 per cent of the invested capital (i. e., 9/12 of 20 per cent of \$120,000), or \$18,000, is \$32,000. The tax computed under this bracket is 65 per cent of this amount (i. e., 65 per cent of \$32,000), or \$20,800.

**637** Third bracket.—80 per cent of the amount or portion of the net income in excess of the war profits credit (i. e., 80 per cent of the amount by which \$50,000 exceeds \$11,250, or \$38,750), is \$31,000. The amount of the tax computed under the first and second brackets (\$2,565 plus \$20,800) is \$23,365. The tax computed under this bracket is the amount by which \$31,000 exceeds \$23,365, or \$7,635.

**638** Total tax.—The total tax will be the sum of the taxes computed under the three brackets (i.e., \$2,565 plus \$20,800 plus \$7,635) or \$31,000. (Art. 720, Reg. 45, Rev., Jan. 28, 1921.)



## LIMITATION OF TAX. §302

**639** Art. 731. Short Form of Computation of Limitation.—In any case  
**523** where the net income is at least \$20,000 the computation under section 302 of the statute [¶523] may be shortened as follows:

**640** (1) The tax imposed by subdivision (a) of section 301 shall not exceed \$5,100, plus 80 per cent of the amount of the net income in excess of \$20,000; and

**641** (2) The tax imposed by subdivision (b) of section 301 shall not exceed \$3,400, plus 40 per cent of the amount of the net income in excess of \$20,000.

**642** Where the net income is less than \$20,000 the tax shall not exceed 30 per cent or 20 per cent, as the case may be, of the amount of the net income in excess of \$3,000. (Art. 731, Reg. 45, Rev., Jan. 28, 1921.)

**643** Art. 732. Limitation when return for fractional part of year.—When a return is rendered for a fractional part of a year the limitation shall be computed in the same manner as if the period covered by the return were a full taxable year. (Art. 732, Reg. 45, Rev., Jan. 28, 1921, as amended by T. D. 3245, Nov. 14, 1921.)

**644** Art. 733. Illustration of computation of limitation of tax.—If in the illustration used in Article 720 the invested capital had been \$100,000 and the net income \$80,000, the tax computed under Section 301 (a) of the statute would be \$56,200. Section 302 provides, however, that the tax under Section 301 (a) shall not be more than 30 per cent of the net income in excess of \$3,000 and not in excess of \$20,000 plus 80 per cent of the net income in excess of \$20,000. The tax at the 30 per cent rate will be \$5,100 (Art. 731) and the balance of the tax will be 80 per cent of \$60,000 (the net income in excess of \$20,000), or \$48,000. The total tax will therefore be \$5,100 plus \$48,000 or \$53,100. The tax under Section 301 (a), amounting to \$56,200, will accordingly be reduced to \$53,100. (Art. 733, Reg. 45, Rev., Jan. 28, 1921, as amended by T. D. 3245, Nov. 14, 1921.)

## TAX WHEN PARTLY PERSONAL SERVICE BUSINESS. §303

**645** Art. 741. Apportionment of Invested Capital and Net Income.—

**524** For the purpose of determining whether or not a corporation partly partaking of the nature of a personal service corporation is within the scope of section 303 [¶524] of the statute and also for the purpose of establishing the basis for the computation of the tax, the corporation shall apportion or allocate its invested capital between each trade or business or branch thereof as nearly as may be in accordance with the actual facts, and shall submit with its return an explanatory statement setting forth the manner in which the apportionment of the invested capital employed in the production of each part of its net income has been determined. There must be assigned to any personal service trade or business or branch thereof an amount of invested capital at least as great as that which would ordinarily be employed by a personal service corporation of similar size and standing for the payment of salaries and office ex-

penses, maintenance of library and equipment, credit advances to clients, etc. For the method of determining the portion of the net income derived from each trade or business or branch thereof see article 715 [¶607]. For the definition of "personal service corporation" see [law ¶502 and] articles 1523-1532. (Art. 741, Reg. 45, Rev., Jan. 28, 1921.)

**646 Art. 742. Computation of tax upon net income when partly personal service corporation.**—(1) The tax upon the non-personal service part of the net income is computed upon the basis of (a) such part of the entire average net income for the prewar period as was derived from the same trade or business or branch thereof; (b) such part of the entire average invested capital for the prewar period as was employed in the production of the part of the net income for that period determined under (a); (c) such part of the entire invested capital for the taxable year as has been employed in the production of the net income upon which the tax is being computed; and (d) the same proportion of the specific exemption as the proportion which the part of the net income upon which the tax is being computed is of the entire net income. If the corporation was in existence during the prewar period, but did not conduct this trade or business or branch thereof during that period, the war profits credit shall be computed as provided in section 311 (b) of the statute [¶533].

**647** (2) The tax upon the personal service part of the net income is the same percentage thereof as the tax computed under (1) is of the non-personal service part of the net income. The tax under this paragraph shall in no case be less than 20 per cent of the personal service part of the entire net income, unless the tax upon the entire net income if computed in the ordinary way would be less than 20 per cent of such entire net income. In that event, and in any case in which the amount of the total tax as computed under this article is the same as or greater than the tax as computed in the ordinary way, the tax shall be computed under section 301 [¶510] of the statute. See section 302 [law ¶523] and articles 711-720 [for discussion on the imposition of the tax, beginning at ¶598] and 731-733 [for maximum limitation of the tax, ¶639]. (Art. 742, Reg. 45, Rev., Jan. 28, 1921.)

**648 Art. 743. Illustration of Computation of Tax Where Partly Personal Service Business.**—A corporation is engaged in contracting and construction work (a non-personal service business in which the employment of capital is necessary) and also renders consulting engineering service (a personal service business which if constituting its sole business would bring it within the class of personal service corporations). It has an average prewar invested capital of \$50,000 (of which \$38,000 was used in contracting work and \$12,000 in engineering); an average prewar net income of \$52,000 (of which \$12,000 was derived from contracting and \$40,000 from engineering); an invested capital for 1918 of \$100,000 (of which \$81,000 is used in contracting and \$19,000 in engineering); and a net income for 1918 of \$90,000 (of which \$30,000 is derived from contracting and \$60,000 from engineering).

**649** (1) In computing the tax upon the first or non-personal service part of the net income (i. e., \$30,000 derived from contracting) the specific exemption is \$1,000 (i. e., the same proportion of \$3,000 which



\$30,000 is of the entire net income of \$90,000). The excess profits credit is a specific exemption of \$1,000, plus 8 per cent of the invested capital used in contracting (i. e., 8 per cent of \$81,000) or \$6,480, a total of \$7,480. The war profits credit is a specific exemption of \$1,000, plus the average prewar net income derived from contracting or \$12,000, plus 10 per cent of \$43,000 (the difference in invested capital used in contracting) or \$4,300, making a total of \$17,300.

**650** *First bracket.*—The amount of the net income derived from contracting (\$30,000) in excess of the excess profits credit (\$7,480) and not in excess of 20 per cent of the invested capital (i. e., 20 per cent of \$81,000) or \$16,200 is \$8,720. The tax under this bracket is 30 per cent of this amount (i. e., 30 per cent of \$8,720) or \$2,616.

**651** *Second bracket.*—The amount of the net income derived from contracting (\$30,000) in excess of 20 per cent of the invested capital used in contracting (i. e., 20 per cent of \$81,000) or \$16,200 is \$13,800. The tax computed under this bracket is 65 per cent of this amount (65 per cent of \$13,800) or \$8,970.

**652** *Third bracket.*—Eighty per cent of the amount of the net income derived from contracting in excess of the war profits credit (i. e., 80 per cent of the amount by which \$30,000 exceeds \$17,300 or 80 per cent of \$12,700) is \$10,160. The amount of the tax computed under the first and second brackets (\$2,616 plus \$8,970) is \$11,586. There is no tax under this bracket, as \$10,160 does not exceed \$11,586.

**653** *Tax.*—The tax upon the first portion of the net income (i. e., \$30,000 derived from contracting) is the sum of the taxes computed under the three brackets (i. e., \$2,616 plus \$8,970 plus nothing) or \$11,586. This is 38.62 per cent of \$30,000 of the net income from contracting.

**654** (2) The tax upon the second or personal service part of the net income (i. e., \$60,000 derived from engineering) is the same percentage of such part of the net income (i. e., 38.62 per cent of \$60,000) or \$23,172.

**655** (3) The total tax is the sum of \$11,586 (the tax upon the first part of the net income derived from contracting) and \$23,172 (the tax upon the second part of the net income derived from engineering) or \$34,758. (Art. 743, Reg. 45, Rev. Jan. 28, 1921.)

**656 to 665** Blank.

## EXEMPTIONS.

§304

**666** Art. 751. Corporations exempt from tax.—A corporation whose  
525 net income for a full taxable year of twelve months is less than \$3,000 is exempt from the tax. [For return requirements in such cases see ¶851.] If the taxable period is less than twelve months the corporation is exempt from the tax if its net income for the period is less than the same proportion of \$3,000 as the number of months in the period is of twelve months, any fractional part of a month being counted as the number of days

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in such part of a month divided by 30. Certain classes of corporations, including personal service corporations, named in section 231 [¶667 below] of the statute are also exempt. See articles 511-522 [for discussion of exemption of certain corporations, ¶667 below, from liability to income tax]. [See ¶913.] (Art. 751, Reg. 45, Rev., Jan. 28, 1921.)

**667** Sec. 231 [of the Revenue Act of 1918, as in effect prior to January 1, 1921]. That the following organizations shall be exempt from taxation under this title—

- (1) Labor, agricultural, or horticultural organizations;
- (2) Mutual savings banks not having a capital stock represented by shares;
- (3) Fraternal beneficiary societies, orders, or associations, (a) operating under the lodge system or for the exclusive benefit of the members of a fraternity itself operating under the lodge system, and (b) providing for the payment of life, sick, accident, or other benefits to the members of such society, order, or association or their dependents;
- (4) Domestic building and loan associations and cooperative banks without capital stock organized and operated for mutual purposes and without profit;
- (5) Cemetery companies owned and operated exclusively for the benefit of their members;
- (6) Corporations organized and operated exclusively for religious, charitable, scientific, or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private stockholder or individual;
- (7) Business leagues, chambers of commerce, or boards of trade, not organized for profit and no part of the net earnings of which inures to the benefit of any private stockholder or individual;
- (8) Civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare;
- (9) Clubs organized and operated exclusively for pleasure, recreation, and other non-profitable purposes, no part of the net earnings of which inures to the benefit of any private stockholder or member;
- (10) Farmers' or other mutual hail, cyclone, or fire insurance companies, mutual ditch or irrigation companies, mutual or cooperative telephone companies, or like organizations of a purely local character, the income of which consists solely of assessments, dues, and fees collected from members for the sole purpose of meeting expenses;
- (11) Farmers', fruit growers', or like associations, organized and operated as sales agents for the purpose of marketing the products of members and turning back to them the proceeds of sales, less the necessary selling expenses, on the basis of the quantity of produce furnished by them;
- (12) Corporations organized for the exclusive purpose of holding title to property, collecting income therefrom, and turning over the entire amount thereof, less expenses, to an organization which itself is exempt from the tax imposed by this title;
- (13) Federal land banks and national farm-loan associations as provided in section 26 of the Act approved July 17, 1916, entitled "An Act to provide capital for agricultural development, to create standard forms of investment based upon farm mortgage, to equalize rates of interest upon farm loans, to furnish a market for United States bonds, to create Government depositories and financial agents for the United States, and for other purposes";
- (14) Personal service corporations.

**668 to 681** Blank.



**682** **Art. 752. Net Income Exempt from Tax.**—If a corporation is engaged in the mining of gold, the portion of its net income derived from that source is exempt from tax. The tax on the remaining portion of its net income is the proportion of the tax that would have been payable, had the entire net income been derived from other sources than the mining of gold, which such remaining portion of the net income bears to the entire net income. For the method of determining the net income derived from the mining of gold see article 715 [¶607]. (Art. 752, Reg. 45, Rev., Jan. 28, 1921.)

**683** **Art. 753. Illustration of Computation of Tax where Net Income from Gold Mining.**—In the case of the corporation used as an illustration in article 716 [¶608] let it be assumed that it is engaged in the mining both of gold and of other rare metals; that the Commissioner finds under article 715 [¶607] that \$35,000 of its gross income is properly attributable to the mining of gold; and that \$20,000 of the deductions allowed are properly applicable to the gross income from that source. The portion of the net income attributable to the mining of gold and exempt from tax would be \$15,000. The remaining portion of the net income is \$25,000 and the tax thereon is the same proportion of the tax computed on the entire net income without the benefit of the exemption (i. e., a tax of \$17,600) which the remaining portion of the net income (\$25,000) bears to the entire net income (\$40,000). The tax will therefore be  $\frac{5}{8}$  of the tax of \$17,600 computed without the benefit of the exemption, or \$11,000. (Art. 753, Reg. 45, Rev., Jan. 28, 1921.)

#### APPORTIONMENT OF SPECIFIC EXEMPTION.

§305

**684** **Art. 761. Apportionment of Specific Exemption.**—The specific exemption of \$3,000 is apportioned only in the case where a return is made covering a period of less than twelve months. In such a case the specific exemption is the same proportion of \$3,000 as the number of months in the period is of twelve months, any fractional part of a month being counted as the number of days in such part of a month divided by 30. Thus, in the case of a corporation organized May 12, 1918, and making a return for the period ending December 31, 1918, the exemption is \$1,916.67, that is, the same proportion of \$3,000 as 7  $\frac{20}{30}$  months is of 12 months. This provision is inapplicable where the return is made for a full fiscal year beginning prior to January 1, 1918, and ending after that date, even though the income for such fiscal year is not subject to full taxation under the present statute. (Art. 761, Reg. 45, Rev., Jan. 28, 1921.)

#### PREWAR PERIOD. §310

**685** **Art. 771. Prewar Period.**—The prewar period in the case of each corporation covers so many of the calendar years 1911, 1912 and 1913 during the whole of which it, or a predecessor trade or business, was in existence. See section 330 [law ¶575] of the statute and articles 931-934 [for certain reorganizations, beginning at ¶837]. If a new enterprise was launched in corporate form in June, 1912, its prewar period would accordingly be the calendar year 1913. The prewar period when mentioned without reference to any particular corporation means the calendar years 1911, 1912 and 1913. (Art. 771, Reg. 45, Rev., Jan. 28, 1921.)

## WAR PROFITS CREDIT. §311

**686** Art. 781. War Profits Credit.—Ordinarily the war profits credit  
**530** consists of the sum of the specific exemption of \$3,000 and an amount  
 equal to the average net income of the corporation for the prewar  
 period, plus 10 per cent of the excess of the invested capital for the taxable  
 year over the average invested capital for the prewar period, or minus 10  
 per cent of the excess of the average invested capital for the prewar period  
 over the invested capital for the taxable year. If a return is made for a  
 period of less than twelve months, the amount equal to the average net  
 income for the prewar period plus or minus 10 per cent of the difference  
 between the average invested capital for the prewar period and the invested  
 capital for the taxable year shall be reduced to the same proportion thereof  
 as the number of months in the period is of twelve months. See section 305  
 [law ¶528] of the statute and article 761 [for apportionment of specific  
 exemption ¶684]. If at the time a return is made the net income for the  
 prewar period or the difference between the average invested capital for  
 the prewar period and the invested capital for the taxable year can not be  
 determined, the war profits credit shall be computed in the first instance  
 as provided in the following article [¶688]. If either of these amounts can  
 not eventually be determined, the war profits credit shall be finally deter-  
 mined as provided in the following article [¶688]. See also section 327 [for  
 special cases subject to special tax: law ¶565 and regulations ¶831] and  
 articles 716-720, 743 and 901 [for illustrations of computation of tax, begin-  
 ning at ¶608; ¶648, ¶831]. (Art. 781, Reg. 45, Rev., Jan. 28, 1921.)

**687** Manner of determining average prewar profits and invested capital.  
**547** —Reference is made to your letter of March 8, 1919, relative to  
**564** average net income and invested capital as computed under the  
 Revenue Acts of 1917 and 1918. Assuming in each case a full  
 prewar existence, the computation is similar under both Acts. The average  
 invested capital for the prewar period is one-third of the sum of the invested  
 capital determined for each of the prewar years as provided in the respective  
 Acts. ¶The average net income for the prewar period is one-third of the  
 total net income for the prewar years as provided in the respective Acts.  
 If any of the prewar years showed a net loss, such net loss may not be offset  
 against the net income of the other years in determining the average net  
 income. (Letter to Richard H. Hart, Denver, Col., signed by J. H. Callan,  
 Assistant to the Commissioner, and dated March 24, 1919.)

**688** Art. 782. War profits credit where meager prewar net income.—  
**533** If a corporation had no net income for the prewar period, or if the  
 war profits credit as ordinarily computed (exclusive of the specific  
 exemption of \$3,000) is less than 10 per cent of its invested capital for the  
 taxable year, then the war profits credit consists of the sum of the specific  
 exemption of \$3,000 and an amount equal to 10 per cent of the corpora-  
 tion's invested capital for the taxable year. See article 720 [for illustration,  
 ¶634]. (Art. 782, Reg. 45, Rev., Jan. 28, 1921.)

**689** Acceptance of \$3,000 plus 10% of invested capital for taxable year  
 as war-profits credit.—Read ¶852.

**690** Art. 783. War Profits Credit where no Prewar Period.—If a cor-  
**536** poration had no prewar period, then the war profits credit consists of  
 the sum of the specific exemption of \$3,000 and an amount equal to  
 the same percentage of the invested capital for the taxable year as the aver-



age percentage of net income to invested capital for the prewar period of corporations engaged in a trade or business of the same general class as that conducted by the taxpayer, but not less than 10 per cent of its invested capital for the taxable year. The war profits credit shall be computed in the first instance on the basis of 10 per cent of the invested capital, and when the average percentage of corporations engaged in the same general class of trade or business has been determined [see ¶691] the amount of the tax will if necessary be recomputed. See section 250 of the statute and articles 1001 [for credit, refund, or additional assessment on recomputation] and 784 [for war-profits credit where no prewar period in special circumstances, ¶722]. (Art. 783, Reg. 45, Rev., Jan. 28, 1921.)

**691** The Average Percentages known as the Median.—Reference is made  
538 to your letter of April 4, 1919; with respect to the application of Section 311 (c) of the Revenue Act of 1918 to the returns of corporations entitled to the benefit thereof.

**692** In reply you are advised that the average percentages applicable to the invested capital of corporations coming within Section 311 (c) of the Revenue Act of 1918 are being worked out by this office, but it is not likely that such average percentages will be ready for use prior to the extended date for filing the complete tax returns for the taxable year 1918. [For the average percentages, i. e., the "median," see ¶694.] Therefore, it will be necessary to file such returns and compute the war profits credit on the basis of 10% of the invested capital of the taxpayer for the taxable year as provided by the 1918 Act.

**693** Any adjustments shown to be necessary upon determination and application of the average percentages, as noted above, will be made as soon as practicable thereafter. (Letter to The Corporation Trust Company, signed by Acting Deputy Commissioner P. S. Talbert, and dated May 15, 1919.)

**694** The median: Average percentages of pre-war income to pre-war  
538 invested capital of general classes of corporations, grouped as to trades or businesses, as provided for in Section 311 (c) (2), Revenue Act of 1918.—Section 311 of the Revenue Act of 1918 provides that a corporation which was not in existence during the whole of at least one calendar year during the pre-war period, and therefore received no income during the pre-war period, shall be allowed a specific exemption of \$3,000 and "an amount equal to the same percentage of the invested capital of the taxpayer for the taxable year as the average percentage of net income to invested capital, for the pre-war period, of corporations engaged in trade or business of the same general class as that conducted by the taxpayer; but such amount shall in no case be less than 10 per centum of the invested capital of the taxpayer for the taxable year. Such average percentage shall be determined by the Commissioner on the basis of data contained in returns made under Title II of the Revenue Act of 1917, and the average known as the median shall be used."

**695** In pursuance of this requirement of the law the accompanying table of medians has been compiled and will be used in complying with Section 250 (b), which provides, "As soon as practicable after the return is filed, the Commissioner shall examine it. If it then appears that the correct amount of the tax is greater or less than that shown in the return, the installments shall be recomputed. If the amount already paid exceeds

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that which should have been paid on the basis of the installments as recomputed, the excess so paid shall be credited against the subsequent installments; and if the amount already paid exceeds the correct amount of the tax, the excess shall be credited or refunded to the taxpayer in accordance with the provisions of Section 252."

**696** Inasmuch as the examination of all returns filed will not be completed by the due date of the last installment of 1918 taxes, it is suggested that the taxpayers entitled to credit, based on the appropriate median shown in the accompanying tables, may recompute their tax using a war profits credit based on such median, and file claim for abatement [Form 47, page 1611] for as much of the last installment of the outstanding assessment as the total tax assessed exceeds the tax so recomputed. In any case where the amount already paid exceeds the amount due, with the benefit of the median, claim for refund should also be filed on Form 46 [page 1609]. [See ¶715.]

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**SCHEDULE OF AVERAGE PERCENTAGES.****698 Agriculture and Dependent Pursuits.**

Subdivisions.	Average percentages. Per Cent.
1. Cotton Ginning.....	11.73
2. Cotton Growing.....	Not over 10.
3. Dairying and Dependent Pursuits, including Butter, Cheese, and Condensed Milk.....	" " 10.
4. Fisheries.....	" " 10.
5. Florists, Nurserymen and Seedmen.....	" " 10.
6. Forestry and Forestal Pursuits, Naval Stores, Charcoal Burning and Grinding.....	13.
7. Fruit and Vegetable Growing, including Vineyards, Orchards and Trucking.....	10.

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Subdivisions.	Average percentages	Per cent.
8. Grain Growing.....	Not over	10.
9. Poultry Raising and Products.....	" "	10.
10. Mixed Farming, including Stock Breeding, Stock Raising and General Animal Husbandry. Agricultural Pursuits not elsewhere specified.....	" "	10.

**699** Mining.

1. Cinnabar.....	Not over	10.
2. Clay.....	" "	10.
3. Coal, Anthracite.....	" "	10.
4. Coal, Bituminous.....	" "	10.
5. Copper.....	" "	10.
6. Gravel and Sand.....	" "	10.
7. Gypsum.....		11.81
8. Iron.....	Not over	10.
9. Lead and Zinc.....	" "	10.
10. Limestone.....	" "	10.
11. Natural Gas.....	" "	10.
12. Petroleum.....	" "	10.
13. Phosphate.....	" "	10.
14. Pipe Lines.....		17.24
15. Salt.....	Not over	10.
16. Silver, Complex Ores.....	" "	10.
17. Talc and Soapstone.....	" "	10.

**700** Chemical Manufacturing and Allied Industries.

	Per Cent
1. Baking Powder, Yeast.....	14.14
2. Blacking, Bluing, Whiting, Stains and Dressing, Dyestuffs, Extracts and Coloring Materials, Inks (Printing and Writing), Paints and Varnishes.....	11.44
3. Celluloid and Products.....	Not over 10.
4. Cleansing and Polishing Preparations, Soaps and Washing Compounds.....	10.56
5. Crude Chemicals, including Leading Acids, Fertilizers, etc.....	Not over 10.
6. Druggists' Preparations, including Perfumery, Cosmetics and Patent Medicine Compounds.....	10.98
7. Oils, Vegetable and Animal, including Seed Cake.....	Not over 10.
8. Petroleum Refining, Products and By-Products.....	11.27
9. Chemicals, not elsewhere specified.....	Not over 10.

**701** Manufacturing Foods and Food Preparations.

1. Bread and other Bakery Products, not including Confectionery.....	11.26
2. Canning, Preserving and Evaporating—Fruits, Vegetables, Fish, Oysters and Shrimps.....	10.67
3. Chocolate and Cocoa Products, Candy and Confectionery.....	Not over 10.
4. Coffee-Roasting, Grinding Spices, and Coffee Substitutes.....	10.87
5. Flavoring Extracts, Syrups and Cordials used in Bottling Industries.....	Not over 10.

**Manufacturing foods and food preparations.—Concluded.**

Subdivisions.	Average percentages. Per Cent.
6. Flour, Feed and Grist Mills.....	Not over 10.
7. Meat Packing, Packing-House Products and By-Products.....	10.
8. Oleomargarine and other Butter and Lard Substitutes, including both Animal and Vegetable.....	12.45
9. Pickling Establishments.....	Not over 10.
10. Rice Mills, Cleaning and Polishing, not including Rice Flour.....	10.
11. Special Package Foods, such as Cornstarch, Macaroni, Tapioca, etc., Breakfast Foods and other Cereal Products.....	10.79
12. Sugar—Beet, including Refining, Molasses Recovery	Not over 10.
13. Sugar—Cane, including Molasses and Syrup in Bulk..	10.
14. Syrups and Molasses—Glucose and others, including Maple.....	10.
15. Vinegar and Cider.....	10.
16. Food Preparations, not elsewhere specified.....	10.83

**702****Iron and Steel Industries.**

	Per Cent.
1. Agricultural Implements.....	Not over 10.
2. Automobiles and Auto Parts, including Bicycles and Motorcycles and parts. Motor Trucks and Motor Truck parts.....	10.
3. Blast Furnace Products.....	10.
4. Boilers, Evaporating Pans, Oil Tanks and Silos.....	10.
5. Bolts and Nuts, including Washers and Rivets.....	10.
6. Engines—Steam, Gas and Oil.....	10.
7. Forging and Foundry Products, including Castings, Car Wheels and Stoves.....	10.
8. Hardware, Special and General.....	10.
9. Heating, Cooling and Ventilating Apparatus, including Furnaces (no stoves), Refrigerating Plants, Dust Collecting Systems.....	10.
10. Machinery—Electrical and other Electrical Apparatus.....	10.
11. Machinery—Excavating, Cars and Tools.....	10.
12. Machinery—Hoisting, Cranes, Derricks and Conveyors	10.
13. Machinery—Humidifying, Air Moistening and Air Conditioning.....	10.
14. Machinery—Laundry.....	10.
15. Machinery—Mill, neither Textile nor Woodworking....	10.
16. Machinery—Mining.....	10.
17. Machinery—Printing and Duplicating.....	10.
18. Machinery—Saw Mill.....	Not over 10.
19. Machinery—Textile, also Parts.....	10.42
20. Machinery—Woodworking.....	Not over 10.
21. Machines—Adding and Calculating.....	10.
22. Machines—Check-writing, Slot, Testing, Vending, Weighing, including Addressographs, Balances, Scales, Registering Devices, and Watchman's Clocks	10.
23. Machines—Sewing.....	10.



## WAR-PROFITS AND EXCESS-PROFITS TAX REGULATIONS.—1918 ACT.

## Iron and Steel Industries.—Concluded.

Subdivisions.	Average percentages. Per Cent.
24. Meters—Gas, Water, etc.....	Not over 10.
25. Plumbing Supplies, including Gas and Water Apparatus, Porcelain Wares for Kitchen and Laundry....	" " 10.
26. Pumps.....	" " 10.
27. Railway Equipment, including Locomotives, Street Railway, Mining and Industrial Cars.....	" " 10.
28. Safes and Vaults.....	" " 10.
29. Shipbuilding.....	" " 10.
30. Steel Plants and Rolling Mill Products, including Tin and Terne Plate Mill Products, Iron and Steel Chains, Steel Doors and Shutters.....	" " 10.
31. Structural Steel.....	" " 10.
32. Tin Cans and Tin Ware.....	" " 10.
33. Tools—Farm, Garden, Machine, Mechanics, Mining, Lumbering, Railroad Track Repairing, including Bench Lathes, Shears and Saws.....	" " 10.
34. Tractors—Farm and Highway.....	" " 10.
35. Typewriters and Typesetting Machinery.....	" " 10.
36. Wire Cables, Fences, Springs, Nails and Spikes.....	10.24
37. Iron and Steel Products not elsewhere specified.....	Not over 10.

## 703 Leather and Leather Goods Industries.

	Per Cent.
1. Boots and Shoes.....	10.94
2. Leather Manufacture.....	10.69
3. Leather Substitutes.....	11.82
4. Leather Articles other than Boots and Shoes.....	Not over 10.

## 704 Liquors and Beverages

	Per Cent
1. Bottling of Liquors and Soft Drinks as distinct from Manufacturing.....	Not over 10.
2. Distillers of Whiskies and Spirits, Refining and Rectifying of Liquors and Beverages.....	" " 10.
3. Malt Liquors (Brewers).....	" " 10.
4. Wines.....	" " 10.
5. Non-Intoxicating Beverages—Coca-Cola and other Special Drinks, Mineral, Soda, and Aerated Waters, including Bottled Tonic Drinks, Soft Drinks, Spring Waters, Malting Grains. All others not elsewhere specified.....	" " 10.

## 705 Lumber and Woodworking Industries.

	Per Cent.
1. Box Boards, Baskets, Cases.....	Not over 10.
2. Caskets, Coffins, Burial Cases of Wood, not including Steel or Concrete.....	" " 10.
3. Furniture, all Classes, including Veneering, Chair Seating.....	" " 10.

## WAR-PROFITS AND EXCESS-PROFITS TAX REGULATIONS.—1918 ACT.

## Lumber and Woodworking Industries—Concluded.

Subdivisions.	Average Percentages.
	Per Cent.
4. Mills—Shingle, Lath.....	Not over 10.
5. Paper Pulp and Pulp Board.....	" " 10.
6. Planing Mills, Flooring, Sash, Doors, Partitions and Interior Work Generally.....	" " 10.
7. Ready-Made Houses.....	" " 10.
8. Silos and Silo Materials, Cooperage Stock, Tanks, not including Steel or Concrete.....	" " 10.
9. Timbering, Logging and Saw Mill Operations.....	" " 10.
10. Wagons and Buggies.....	" " 10.
11. Wood Fibres, Leatheroid, Wood Composition in other Commodities.....	" " 10.
12. Woodworking Industries, not elsewhere specified.....	" " 10.

## 706

## Metal and Metallurgical Extractions.

	Per Cent
1. Brass, Bronze, Copper and Aluminum Products.....	Not over 10.
2. Clocks, Watches, Chronometers.....	" " 10.
3. Cooking Utensils (other than Copper), Granite Goods, etc.....	" " 10.
4. Cutlery, Scissors, Razors.....	" " 10.
5. Galvanized Materials, Spouting, Gutters, Metal Roofing.....	" " 10.
6. Gas and Electric Fixtures.....	" " 10.
7. Jewelry.....	" " 10.
8. Lamps and Accessories.....	" " 10.
9. Lead Products.....	" " 10.
10. Needles, Pins, Metal Hair Pins, and Pen Points.....	" " 15.54
11. Plate Ware, Electroplate, etc.....	Not over 10.
12. Professional and Scientific Instruments, including Dental Supplies, and Optical Goods, Surgical and Hospital Appliances, Photographic Apparatus and Materials.....	10.50
13. Silverware and Goldware, other than Jewelry.....	Not over 10.
14. Smelting and Refining—Copper, Lead, Zinc, etc.....	" " 10.
15. Metal and Metallurgical Industries, not elsewhere, specified.....	" " 10.

## 707

## Paper Manufacturing, Printing, Bookbinding, Publishing.

	Per Cent.
1. Blank Paper.....	Not over 10.
2. Book and Job Printing, Lithographing, including Bank Note and Bond Printing, Labels, Tags and Decorative Paper.....	" " 10.
3. Book Binding and Blank Book Making.....	" " 10.
4. Cardboard, Box Materials, and Box Manufacturer.....	10.48
5. Envelopes.....	10.28
6. Paper Utensils.....	Not over 10.
7. Photo-Engraving and Printing Processes.....	" " 10.
8. Printing Materials.....	" " 10.



## WAR-PROFITS AND EXCESS-PROFITS TAX REGULATIONS.—1918 ACT.

## Paper Manufacturing, Printing, Bookbinding, Publishing—Concluded.

Subdivisions.	Average Percentages.
	Per Cent.
9. Publishing Newspapers and other Periodicals.....	Not over 10.
10. Type Founding, Stereotyping and Electrotyping.....	13.17
11. Wall Paper.....	Not over 10.
12. Wrapping Paper.....	" " 10.
13. Paper and Printing, not elsewhere specified.....	" " 10.

## 708 Stone, Clay and Glass Industries.

	Per Cent.
1. Abrasive Products, including Emery Wheels, Sandpaper and Corundum.....	12.72
2. Building Brick Sewer and Drainage Pipe, Fire Brick, Furnace Linings, Pottery, Terra-Cotta, Crucibles, Tiling, Laundry Tubs, Refractories and Earthenware.....	Not over 10.
3. Cement.....	" " 10.
4. Concrete Construction, including Artificial Stone.....	" " 10.
5. Glassware, including Household, Hotel, and Bar-room Supplies, X-Ray Tubes, Thermos Bottles, Mirrors, Refractors, Illuminating Glass, etc.....	" " 10.
6. Glass—Window, Wire and Skylight.....	" " 10.
7. Lime and Plaster.....	" " 10.
8. Monuments; Tombstones, Burial Vaults.....	" " 10.
9. Porcelain Goods and Ceramic Products, not elsewhere specified.....	" " 10.

## 709 Textile Industries.

	Per Cent.
1. Awnings, Tents, Tarpaulins, etc.....	11.88
2. Bags and Bagging—Cotton and Burlap.....	17.34
3. Batting Mills.....	Not over 10.
4. Carpets and Rugs, including Cotton, Wool and Grass...	" " 10.
5. Clothing—Men's Overcoats, Suits, etc.....	" " 10.
6. Clothing—Ladies', Coats, Suits and Dresses.....	" " 10.
7. Clothing—Miscellaneous. Uniforms, Furriers, Regalia, Belts, Garters, etc.....	" " 10.
8. Corsets and Brassiers.....	19.90
9. Cotton Converters, Dyers, Finishers, Mercerizers Bleachers and Prints.....	" " 10.
10. Cotton Duck.....	11.90
11. Cotton Goods Manufacturing—Colored, Fancy, Grey, Brown, Print Cloth and Sheeting.....	Not over 10.
12. Cotton Laces, Curtains, Quilts, Embroideries.....	" " 10.
13. Cotton Spinning—Fine Yarns.....	10.17
14. Cotton Spinning—Medium and Coarse Yarns.....	Not over 10.
15. Dyers of Furs.....	11.97
16. Hats, Caps, Scarfs and other Headwear and Neckwear	Not over 10.
17. Hosiery and Knit Goods, including Knitted and Fabric Underwear.....	" " 10.
18. Millinery and Millinery Goods.....	" " 10.
19. Rope and Cordage.....	" " 10.

## WAR-PROFITS AND EXCESS-PROFITS TAX REGULATIONS.—1918 ACT.

## Textile Industries.—Concluded.

Subdivisions.	Average Percentages.
	Per Cent.
20. Shirts, Collars and Cuffs.....	“ “ 10.
21. Silk-Dyeing and Finishing.....	12.10
22. Silk Manufacturing—Broad.....	Not over 10.
23. Silk Manufacturing—Ribbons, Woven Labels.....	“ “ 10.
24. Silk—Spinning.....	“ “ 10.81
25. Silk—Throwing.....	“ “ 10.
26. Thread, Tapes and Braids, Cotton and Silk.....	“ “ 10.
27. Towels, Damask, Handkerchiefs (Cotton and Linen)...	“ “ 10.
28. Upholstery Cloth and Trimmings (Cotton and Wool)...	“ “ 10.
29. Waste—Cotton and Wool, Linters and Oakum.....	11.
30. Wool and Worsted—Dyeing and Finishing.....	Not over 10.
31. Wool and Worsted—Spinning and Combing.....	“ “ 10.
32. Wool and Worsted Weaving.....	“ “ 10.
33. Textile Manufacturing, not elsewhere specified.....	“ “ 10.

## 710

## Special Manufacturing Industries.

1. Ammunition, Explosives and Fireworks.....	11.28
2. Artificial Flowers.....	Not over 10.
3. Artificial Limbs.....	“ “ 10.
4. Asbestos Wares, Magnesia, Material for Insulation.....	16.88
5. Bedding, Mattresses and Undertakers' Supplies.....	Not over 10.
6. Brooms and Brushes.....	“ “ 10.
7. Buttons, Beads, Rosaries.....	“ “ 10.
8. Coke.....	“ “ 10.
9. Combs—Bone, Ivory, etc.....	“ “ 10.
10. Dairymen's, Poultrymen's and Apiarist's Supplies.....	“ “ 10.
11. Fire Extinguishers, including Mechanical and Chemical Apparatus, Automatic Sprinklers, Fire Trucks.....	“ “ 10.
12. Hair Goods.....	“ “ 10.
13. Hand Stamps—Rubber, Metal, etc.....	“ “ 10.
14. House Furnishing Goods, Screen Doors and Windows, Window Shades.....	“ “ 10.
15. Ice.....	“ “ 10.
16. Jewelry and Instrument Cases.....	“ “ 10.
17. Models and Patterns (not including Paper Patterns), Molds.....	“ “ 10.
18. Mucilage and Paste.....	11.23
19. Phonographs and all other Musical Instruments and Parts (not including Pianos, Organs and Parts).....	11.53
20. Pianos, Organs and Parts.....	Not over 10.
21. Roofing Materials other than Metal.....	“ “ 10.
22. Rubber—Boots, Shoes and Clothing.....	“ “ 10.
23. Rubber—Tires, Belting, Hose, Tubing, including non-Metallic Conduits.....	“ “ 10.
24. Rubber Goods, not elsewhere specified.....	“ “ 10.
25. Shipbuilding—Wooden Craft of all kinds.....	10.15
26. Signs and Advertising Novelties.....	14.45
27. Small Metal Specialties.....	Not over 10.
28. Soda Fountain Apparatus, Siphons.....	15.20

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## WAR-PROFITS AND EXCESS-PROFITS TAX REGULATIONS.—1918 ACT.

## Special manufacturing industries.—Concluded.

Subdivisions.	Average Percentages. Per Cent.
29. Sporting and Athletic Goods (including Pleasure Boats, but not Yachts), Amusement Appliances.....	Not over 10.
30. Stationery Goods, School Supplies, Office System Supplies.....	10.36
31. Stencil, Dye Sinking, Seals.....	Not over 10.
32. Tobacco.....	12.87
33. Toys, Children's Tools and Vehicles, including Baby Carriages, Carts, Games and Christmas Novelties....	Not over 10.
34. Umbrellas and Canes.....	" " 10.
35. Washing Machines and Clothes Wringers.....	12.22
36. Windmills.....	Not over 10.
37. Special Products, not elsewhere specified.....	" " 10.

## FINANCIAL.

## 711 Banks, Insurance Companies, Brokerage Institutions.

	Per Cent.
1. Banking—International.....	Not over 10.
2. Banking—Private, Money Lenders and Pawnbrokers " "	10.
3. Banking—Saving.....	" " 10.
4. Banking—State and National.....	" " 10.
5. Banking—Trust Companies.....	" " 10.
6. Banking and Financial Operations, not elsewhere specified.....	" " 10.
7. Building and Loan Associations.....	" " 10.
8. Burglar Alarm Systems.....	" " 10.
9. Holding Companies, Incorporated Estates, Trusts, Investment Concerns.....	" " 10.
10. Insurance Brokers.....	" " 10.
11. Insurance—Fidelity and Surety.....	" " 10.
12. Insurance—Fire, Mutual.....	" " 10.
13. Insurance—Fire, Stock.....	" " 10.
14. Insurance—Life, Mutual.....	" " 10.
15. Insurance—Life, Stock.....	" " 10.
16. Insurance—Marine.....	" " 10.
17. Insurance—Casualty, Mutual.....	" " 10.
18. Insurance—Casualty, Stock.....	" " 10.
19. Insurance—Title and Abstract.....	" " 10.
20. Insurance—not elsewhere specified.....	" " 10.
21. Safe Deposit Vaults.....	" " 10.
22. Stock Brokers and Dealers in Securities on Commission.....	" " 10.

## 712 Common Carriers and Public Utilities.

	Per Cent.
1. Cold Storage and Ice.....	Not over 10.
2. Cotton Compressors and Cotton Storage.....	" " 10.
3. Gas Companies, Illuminating and Fuel.....	" " 10.
4. Grain Elevators.....	" " 10.
5. Irrigation Water Works.....	" " 10.

## WAR-PROFITS AND EXCESS-PROFITS TAX REGULATIONS.—1918 ACT.

## Common Carriers and Public Utilities—Concluded.

Subdivisions.	Average Percentages. Per Cent.
6. Light and Power, including Water and Electric, Hydro-electric Lighting.....	Not over 10.
7. Market Houses—Public.....	10.
8. Railways—Electric, City, Suburban and Interurban....	10.
9. Railway Express Companies.....	13.89
10. Railways—Steam.....	Not over 10.
11. Steamships—Local, River, Lake, Coastwise and Ocean Lines.....	10.
12. Stock Yards.....	10.
13. Tank Car Companies, Refrigerator, Ventilator, and Live Stock Cars.....	10.
14. Telephone and Telegraph Companies.....	10.
15. Warehouses and Storage, other than Cotton Storage, Wharves, Forwarding, Teaming, Stevedoring, Local Express.....	10.
16. Water Filtration, Distribution for Domestic Use.....	10.
17. Common Carriers and Public Utilities, not elsewhere specified; Toll bridge, Bridge Companies, Ferry, Turnpike, United Press Association, Passenger Bus Line, Canals, etc.....	10.

## 713 Trading and Miscellaneous.

	Per Cent.
1. Brokers—Freight, Grain, Merchandise, Real Estate and Ship, Purchasing and Selling Agents, Manufacturer's Agents, Exporters and Importers (Commission only), Automobiles, Sales of Metals.....	Not over 10.
2. Garages and Livery Stables.....	10.
3. Jobbers—Merchandise, General and Special.....	10.
4. Merchant Tailoring, Needlework, etc.....	17.14
5. Merchants—Retail.....	Not over 10.
6. Merchants—Wholesale.....	10.45
7. Real Estate Operators and Promoters.....	Not over 10.
8. Trading Concerns not elsewhere specified.....	10.
9. Amusements, Theatres, Moving Picture Shows, County Fairs, Race Tracks and Clubs.....	10.
10. Barbers, Bathhouses, etc.....	10.
11. Consulting Engineers, Appraisers, Accountants, Adjusters, Architects, Chemists, Assayers and Metallurgists.....	10.
12. Contractors, Building Construction, Street Paving, Machine Installation, etc.....	10.
13. Decorators and Interior Designing.....	10.
14. Hospitals, Sanitariums, etc.....	10.
15. Hotels.....	10.
16. Laundries, Dry Cleaning, Dyeing, etc.....	10.
17. Photographs and Art Portraits.....	19.66
18. Restaurants.....	Not over 10.
19. Schools, Colleges, etc.....	10.
20. Undertakers.....	10.



## WAR-PROFITS AND EXCESS-PROFITS TAX REGULATIONS.—1918 ACT.

Trading and Miscellaneous.—Concluded.  
Subdivisions.

Average Percentage  
Per Cent

21. Miscellaneous Concerns, not elsewhere specified, including Typewriter Exchange, Type-setting, Advertising Services, Commercial Agencies and Detective Agencies. " " 10.

714 Chart—Showing the Average Percentages of Net Income to Invested Capital for the Prewar Period, and the Number of Industrial Groups of the Same Class of Business Under Each Median.

Industry	Total number of industrial sub-divisions.	Medians or average percentages of net income to invested capital.										
		10% and under.	Over 10% and under 11%.	11% and under 12%.	12% and under 13%.	13% and under 14%.	14% and under 15%.	15% and under 16%.	16% and under 17%.	17% and under 18%.	18% and under 19%.	19% and under 20%.
Agriculture and dependent pursuits.....	10	8	.....	1	.....	1	.....	.....	.....	.....	.....	.....
Mining.....	17	15	.....	1	.....	.....	.....	.....	.....	1	.....	.....
Financial: Banks, insurance companies, brokerage institutions....	22	22	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....
Common carriers and public utilities.....	17	16	.....	.....	.....	1	.....	.....	.....	.....	.....	.....
Iron and steel.....	37	35	2	.....	.....	.....	.....	.....	.....	.....	.....	.....
Chemical manufacturing and allied industries.....	9	4	2	2	.....	.....	1	.....	.....	.....	.....	.....
Manufacturing foods and food products ..	16	10	4	1	1	.....	.....	.....	.....	.....	.....	.....
Leather and leather goods industries.....	4	1	2	1	.....	.....	.....	.....	.....	.....	.....	.....
Liquors and beverages ..	5	5	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....
Metal and metallurgical extractions.....	15	13	1	.....	.....	.....	.....	1	.....	.....	.....	.....
Paper manufacturing, printing, bookbinding publishing.....	13	10	2	.....	.....	1	.....	.....	.....	.....	.....	.....
Special manufacturing industries.....	37	27	2	3	2	.....	1	1	1	.....	.....	.....
Stone, clay and glass industries.....	9	8	.....	.....	1	.....	.....	.....	.....	.....	.....	.....
Textile industries.....	33	25	1	4	1	.....	.....	.....	.....	1	.....	1
Lumbering and wood-working industries ..	12	12	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....
Trading and miscellaneous.....	21	18	1	.....	.....	.....	.....	.....	.....	1	.....	1
Total.....	277	229	17	13	5	3	2	2	1	3	.....	2

715 Comment: The foregoing, ¶694 to ¶714, is a reprint of the "median" and foreword prepared by the Bureau of Internal Revenue, and released for publication November 24, 1919. This is designated as "Bulletin D."—The Corporation Trust Company.

716 to 721 Blank.

**722 Art. 784. War Profits Credit where no Prewar Period in Special**  
**539 Circumstances.**—If a corporation had no prewar period, but (a) if a majority of its stock at any time during the taxable year was owned or controlled by a corporation which was in existence during the whole of at least one calendar year during the prewar period, or (b) if 50 per cent or more of its gross income consisted of income derived from Government contracts made after April 5, 1917, and before November 12, 1918, then the war profits credit is to be determined as provided in article 782 [¶688 instead of in the manner provided in article 783 [¶690]. See section 1 of the statute [law ¶503] and article 1510 [for definition of government contract]. (Art. 784, Reg. 45, Rev., Jan. 28, 1921.)

**723 Art. 785. War Profits credit in the case of affiliated corporations.**  
 —In the case of affiliated corporations making a consolidated return only one specific exemption of \$3,000 is allowed. See also sections 240 [for specific exemption in case of consolidated returns, ¶588] and 305 of the statute [law ¶528] and article 761 [regulations ¶684, for apportionment of specific exemption]. (Art. 785, Reg. 45, Rev., Jan. 28, 1921.)

#### EXCESS PROFITS CREDIT.

§312

**724 Art. 791. Excess Profits Credit.**—The excess profits credit consists of the specific exemption of \$3,000 plus an amount equal to 8 per cent of the invested capital for the taxable year. In the case of affiliated corporations making a consolidated return only one specific exemption of \$3,000 is allowed. See also sections 240 [for specific exemption in case of consolidated returns, ¶588] and 305 of the statute [law ¶528, and regulations ¶684 for apportionment of specific exemption] and articles 716-720, 743, and 761 [for illustrations, beginning at ¶608, ¶648, and ¶684]. (Art. 791, Reg. 45, Rev., Jan. 28, 1921.)

#### NET INCOME.

§320

**725 Art. 801. Net Income.**—The net income of a corporation for the  
**543 purpose** of the imposition of the war profits and excess profits tax is the same net income [see ¶726 below] as determined for the purpose of the income tax. See section 232 of the statute and article 531. For the prewar period, however, the net income of a corporation is to be ascertained in the case of the calendar years 1911 and 1912 as provided in section 38 of the Act of August 5, 1909, and in the case of the calendar year 1913 as provided in section II of the Act of October 3, 1913, except that in either case the amount of any taxes imposed by section 38 of the Act of August 5, 1909, and paid within the year in question should be included and that in the case of the calendar year 1913 any dividends received from other corporations taxed under section II of the Act of October 3, 1913, should be deducted. (Art. 801, Reg. 45, Rev., Jan. 28, 1921.)

**726 Interest on Liberty Bonds and Victory Notes, and on War Finance Corporation Bonds.**—[Sec. 213 (b) (4) of the Revenue Act of 1918 reads in part as follows:]—"In the case of obligations of the United States issued after September 1, 1917, and in the case of bonds issued by the War Finance Corporation, the interest shall be exempt only if and to the extent provided in the respective Acts authorizing the issue thereof as amended and supplemented, and shall be excluded from gross income only if and to the extent it is wholly exempt from taxation to the taxpayer both under



this title [Income Tax] and under Title III [excess-profits tax].” [Sec. 236 (a) of the Revenue Act of 1918 provides that for the purpose of the income tax imposed on corporations, there shall be allowed as a credit], “(a) The amount received as interest upon obligations of the United States and bonds issued by the War Finance Corporation, which is included in gross income under section 233 [which section refers back to Sec. 213, quoted above];” [furthermore the Acts authorizing the issue of Liberty bonds and War Finance Corporation bonds, and the Act authorizing the issue of Liberty notes (considering the series elected by the Secretary of the Treasury under the authority given to him by the Act itself), exempts the interest from such bonds and notes from income tax in the case of corporations; therefore all interest on all Government obligations and interest on War Finance Corporation bonds is free of income tax to corporations: The extent to which such interest was exempt for excess-profits tax purposes prior to January 1, 1921, is shown below.]

**727 Tax exemptions of Liberty Bonds and Victory Notes Prior to January 1, 1921.**—The appended circular, issued under date of April 23, 1919 [as amended became Art. 80 (a), Reg. 45, Rev., Jan. 28, 1921, ¶728], with reference to the tax exemptions of Liberty Bonds and Victory Notes, is published for the information of internal-revenue officers and others concerned. (T. D. 2836, May 7, 1919.)

**728 Tax exemptions of Liberty Bonds and Victory Notes.**—Liberty bonds and Victory notes issued under authority of the acts of Congress approved April 24, 1917, September 24, 1917, April 4, 1918, July 9, 1918, September 24, 1918, and March 3, 1919, are entitled, respectively, to the exemptions from taxation set forth in said acts, from which the statements in this article are summarized, and to which they are subject.

**1. 4 per cent and  $4\frac{1}{4}$  per cent bonds** are exempt from all Federal, State and local taxation, except (a) estate or inheritance taxes and (b) Federal income surtaxes and profits taxes, as follows:

1. First Liberty loan converted 4 per cent bonds of 1932-1947 (first 4s).
2. First Liberty loan converted  $4\frac{1}{4}$  per cent bonds of 1932-1947 (first  $4\frac{1}{4}$ s, issue of May 9, 1918).
3. First Liberty loan second converted  $4\frac{1}{4}$  per cent. bonds of 1932-1947 (first  $4\frac{1}{4}$ s, issue of October 24, 1918).
4. Second Liberty loan 4 per cent. bonds of 1927-1942 (second 4s).
5. Second Liberty loan converted  $4\frac{1}{4}$  per cent bonds of 1927-1942 (second  $4\frac{1}{4}$ s).
6. Third Liberty loan  $4\frac{1}{4}$  per cent. bonds of 1928 (third  $4\frac{1}{4}$ s).
7. Fourth Liberty loan  $4\frac{1}{4}$  per cent. bonds of 1933-1938 (fourth  $4\frac{1}{4}$ s).
8. Victory Liberty loan  $4\frac{3}{4}$  per cent. convertible gold notes of 1922-1923 ( $4\frac{3}{4}$  per cent Victory notes).

are exempt, both as to principal and interest, from all taxation now or hereafter imposed by the United States, any State, or any of the possessions of the United States, or by any local taxing authority, except (a) estate or inheritance taxes, and (b) graduated additional income taxes, commonly known as surtaxes, and excess-profits and war-profits taxes, now or hereafter imposed by the United States, upon the income or profits of individuals, partnerships, associations, or corporations.

The exemptions in the tabulation that follows, apply to periods prior to January 1, 1921.

*For exemptions applying on and after January 1, 1921, see ¶1089.*

[For periods prior to Jan. 1, 1921.]

- II. 4 per cent and  $4\frac{1}{4}$  per cent Liberty bonds (but not  $4\frac{3}{4}$  per cent Victory notes) treasury certificates, and war savings certificates are entitled to certain limited exemptions from graduated additional income taxes, commonly known as surtaxes, and excess-profits and war-profits taxes, now or hereafter imposed by the United States, upon the income or profits of individuals, partnerships, associations, or corporations, in respect to the interest on principal amounts thereof, as follows:
- \$5,000 in the aggregate of first 4s, first  $4\frac{1}{4}$ s (issues of May 9 and October 24, 1918), second 4s and  $4\frac{1}{4}$ s, third  $4\frac{1}{4}$ s, fourth  $4\frac{1}{4}$ s, Treasury certificates, and war-savings certificates.
  - 30,000 of first  $4\frac{1}{4}$ s (issue of October 24, 1918, only), until the expiration of two years after the termination of the war.
  - 30,000 of fourth  $4\frac{1}{4}$ s, until the expiration of two years after the termination of the war.
  - 30,000 in the aggregate of first 4s, first  $4\frac{1}{4}$ s (issues of May 9 and October 24, 1918), second 4s and  $4\frac{1}{4}$ s, third  $4\frac{1}{4}$ s, and fourth  $4\frac{1}{4}$ s, as to the interest received on and after January 1, 1919, until the expiration of five years after the termination of the war.
  - 45,000 in the aggregate of first 4s, first  $4\frac{1}{4}$ s (issue of May 9, 1918, only), second 4s and  $4\frac{1}{4}$ s, and third  $4\frac{1}{4}$ s, as to the interest received after January 1, 1918, until the expiration of two years after the termination of the war; this exemption conditional on original subscription to, and continued holding at the date of the tax return of two-thirds as many bonds of the fourth Liberty loan.
  - 20,000 in the aggregate of first 4s, first  $4\frac{1}{4}$ s (issues of May 9, and October 24, 1918), second 4s and  $4\frac{1}{4}$ s, third  $4\frac{1}{4}$ s, and fourth  $4\frac{1}{4}$ s, as to the interest received on and after January 1, 1919; this exemption conditional upon original subscription to, and continued holding at the date of the tax return of one-third as many notes of the Victory Liberty loan, and extending through the life of such notes of the Victory Liberty loan.

160,000 total possible exemptions from Federal income surtaxes and profits taxes, subject to conditions above summarized.

III.  $3\frac{1}{2}$  per cent bonds and  $3\frac{3}{4}$  per cent notes are exempt from all Federal, State, and local taxation, except estate or inheritance taxes, as follows:

- |  |   |
|--|---|
| 1. First Liberty loan  | } Are exempt, both as to principal and interest, from all taxation (except estate or inheritance taxes) now or hereafter imposed by the United States, any State, or any of the possessions of the United States, or by any local taxing authority. |
| $3\frac{1}{2}$ per cent bonds of 1932-1947.                  |   |
| 2. Victory Liberty loan                                      | }   |
| $3\frac{3}{4}$ per cent convertible gold notes of 1922-1923. |   |

(Art. 80(a), Reg. 45, Rev., Jan. 28, 1921.)



**729** Income of a corporation as such is taxable to the corporation and is not taxable to the stockholders. The corporation, and not the stockholders, is regarded as the owner of the bonds held by the corporation and entitled to exemption on account of such ownership. When bonds of the Fourth Liberty Loan are subscribed for by the corporation it, and not the stockholders, is the original subscriber and entitled to the collateral exemption of interest on bonds of previous issues on account of such original subscription. (T. D. 2762, Oct. 18, 1918.)

**730** Original subscription to Victory Notes.—For the purposes of the additional tax exemption for Liberty Bonds granted by Section 2 (b) of the Victory Loan Act, approved March 3, 1919, Victory notes of either series issued upon conversion of Victory notes of the other series which were originally subscribed for by any taxpayer will be deemed to have been originally subscribed for by such taxpayer. (T. D. 2857, June 7, 1919.—Art. 80, Reg. 45, Rev., Jan. 28, 1921.)

**731** Blank.

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[Not limited to periods prior to Jan. 1, 1921.]

**732** Taxable status of War Finance Corporation Bond interest.—War Finance Corporation bonds are issued under the authority of the Act of April 5, 1918, which provides that the interest on the amount of such bonds, the principal of which does not exceed \$5,000, shall be exempt from normal taxes, surtaxes, excess profits and war profits taxes, and that the interest received by a taxpayer, independent of the amount of his holdings, is exempt from normal Federal tax [which includes the income tax on corporations]. (Official announcement by the Bureau of Internal Revenue, April 5, 1919.)

**733** Interest on all United States Bonds and on War Finance Corporation Bonds entirely exempt from taxation to foreign corporations.—**Sec. 4** [of the Victory Liberty Loan Act]. That section 3 of the Fourth Liberty Bond Act is hereby amended to read as follows:  
 “Sec. 3. That, notwithstanding the provisions of the Second Liberty Bond Act or of the War Finance Corporation Act or of any other Act, bonds, notes, and certificates of indebtedness of the United States and bonds of the War Finance Corporation shall, while beneficially owned by a nonresident alien individual, or a foreign corporation, partnership, or association, not engaged in business in the United States, be exempt both as to principal and interest from any and all taxation now or hereafter imposed by the United States, any State, or any of the possessions of the United States or by any local taxing authority.” (Section 4 of “An Act to amend the Liberty Bond Acts and the War Finance Corporation Act, and for other purposes,” known as the “Victory Liberty Loan Act,” approved by the President, March 3, 1919.)

**734** Art. 802. Prewar net income of affiliated corporations.—The consolidated net income of affiliated corporations for the prewar period shall be the average consolidated net income for the prewar years of such of the several corporations included in the consolidation for the

taxable year as were affiliated during the prewar period, plus the aggregate of the average net income for each of the corporations not affiliated during the prewar period which were in existence during all of the prewar period or during at least one full year within the prewar period. The net income of a subsidiary corporation organized during the prewar period by an existing corporation shall also be included. See also sections 240 and 330 of the statute and articles 631-638 and 931-934 [for "Reorganizations," beginning at ¶837]. (Art. 802, Reg. 45, Rev., Jan. 28, 1921.)

[For *average* prewar income see law ¶547 and ¶687.]

**735 Liberty Bond interest exemption, consolidated returns, bonds all being owned by parent corporation.**—Receipt is acknowledged of your letter of March 25, 1919, in which you state that the \_\_\_\_\_ Company is affiliated with various subsidiaries in which the \_\_\_\_\_ Company owns all the stock directly or owns the stock of the company which does own all the stock of such affiliated company. The \_\_\_\_\_ Company has on hand an investment in Liberty Bonds amounting to \$2,345,000 of the second, third and fourth issues. ¶You inquire if the \_\_\_\_\_ Company may apportion the Liberty Bonds held by it among its several subsidiaries in order to determine the total exemption allowable for purposes of a consolidated return. ¶In reply you are advised that in cases of consolidated returns, affiliated corporations are treated as if they were one corporation and the tax is based upon the consolidated income and the consolidated invested capital of these corporations. Whether the parent company owns the bonds or apportions them among its subsidiaries, makes no difference in the amount of exemption allowable in cases where consolidated returns are required, as such exemption is based upon the consolidated condition. (Letter to The Corporation Trust Company, signed by Commissioner Daniel C. Roper, and dated April 5, 1919.)

**736 Liberty Bond interest exemption, consolidated returns, bonds being owned by each of the affiliated corporations.**—Reference is made to your letter dated April 22, 1919, in which you question the validity of a ruling in connection with exemptions to which several affiliated corporations included in a consolidated return are entitled on account of their ownership of various issues of Liberty Bonds appearing in a letter from Acting Commissioner J. H. Callan dated April 16, 1919, to The Corporation Trust Company and printed in the War Tax Service, 1919, to the effect that:

"Whether each of the subsidiary companies owns the bonds or whether the parent company, or any one of the companies alone, owns the exempt bonds makes no difference in the amount of exemption allowable in cases where consolidated returns are required, as such exemptions are based upon the consolidated condition."

**737** Upon further consideration this office rules that each of several affiliated corporations included in a consolidated return under Section 240 of the Revenue Act of 1918 is entitled to the same full benefits under the exemption provisions of the several Liberty Bond Acts to which it would be entitled if not affiliated. (Letter to one of our subscribers, signed by Commissioner Daniel C. Roper, and dated May 21, 1919.)



## TERMS RELATING TO INVESTED CAPITAL.

§325

**738** Art. 811. **Intangible and Tangible Property.**—Intangible prop-  
**549** erty includes patents and good will and other like property. Tan-  
**550** gible property includes all property other than intangible property.

Most contracts are intangible property and in the absence of a specific ruling by the Commissioner to the contrary should be so regarded for the purpose of making returns. A contract may be treated as tangible property only after the submission of a full statement as to its exact nature, showing to the satisfaction of the Commissioner that it relates to rights in tangible property to such an extent that its value arises chiefly therefrom. Associated Press, United Press, and similar franchises, and subscription lists and mailing lists, are intangible property. (Art. 811, Reg. 45, Rev., Jan. 28, 1921.)

**739** Art. 812. **Borrowed Capital: Securities.**—Any interest in a cor-  
**551** poration represented by bonds, debentures, or other securities, by  
**561** whatever name called, including so-called preferred stock, if with respect to the payment of either interest or principal it ranks with or prior to the interest of the general creditors, is borrowed capital and cannot be included in computing invested capital. Any such preferred stock may, however, be so included if it is deferred with respect to the payment of both interest and principal to the interest of the general creditors (Art. 812, Reg. 45, Rev., Jan. 28, 1921.)

**740** Art. 813. **Borrowed Capital: Amounts Left in Business.**—Whether  
**551** a given amount paid into or left in the business of a corporation con-  
**561** stitutes borrowed capital or paid-in surplus is largely a question of fact. Thus, indebtedness to stockholders actually cancelled and left in the business would ordinarily constitute paid-in surplus, while amounts left in the business representing salaries of officers in excess of their actual withdrawals, or deposit accounts in favor of partners in a partnership succeeded by the corporation, will be considered paid-in surplus or borrowed capital according to the facts of the particular case. The general principle is that if interest is paid or is to be paid on any such amount, or if the stockholder's or officer's right to repayment of such amount ranks with or before that of the general creditors, the amount so left with the corporation must be considered as borrowed capital and be so treated in computing invested capital. (Art. 813, Reg. 45, Rev., Jan. 28, 1921.)

**741** **Interest-bearing one-year loan to corporation by stockholder although all other creditors are preferred, is not "Invested Capital."**—Principal stockholder of X. Corporation loans \$35,000 to Corporation for one year. In order to protect credit of Corporation, agreement is signed that lender shall be deferred to all other creditors, lender to receive one per cent additional interest in consideration. Can this \$35,000 be included in "invested capital" in nature of preferred stock, the interest not being deducted as expense? (Answer.) Your telegram April second. Question answered in negative. (Telegram of inquiry from Bernhard Knollenberg, Richmond, Indiana, and the reply thereto signed by Commissioner Daniel C. Roper, and dated April 4, 1919.)

**742** **Art. 814. Borrowed Capital: Other Illustrations.**—Items such as  
**551** deposits or amounts due to other banks shown in the balance sheet  
**561** of a bank, unexpired subscriptions shown in the balance sheet of a  
 publishing concern, etc., are deemed liabilities and can not be in-  
 cluded in computing invested capital. (Art. 814, Reg. 45, Rev., Jan. 28,  
 1921.)

**743** **Art. 815. Inadmissible assets.**—Stocks, bonds and other obliga-  
**552** tions (other than obligations of the United States), the dividends  
 or interest from which are not required to be included in computing  
 net income, are inadmissible assets even though no such dividends or interest  
 have been actually paid or received during the taxable year. The failure  
 to pay or to receive dividends or interest does not change the status of such  
 securities as inadmissible assets. A corporation cannot by including the in-  
 come from inadmissible assets as taxable income create the right to have  
 such assets considered admissible assets. (Art. 815, Reg. 45, Rev., Jan. 28,  
 1921.)

**744** **Federal Reserve Bank Stock held to be an inadmissible asset.**—  
 Reference is made to office letter to you dated March 11, 1919, in  
 reply to your letter of February 25, 1919. ¶Through an oversight an errone-  
 ous ruling was made in the above mentioned office letter, relative to Federal  
 Reserve Bank Stock, in connection with invested capital. ¶Federal Reserve  
 Bank Stock, held by a member bank, is held to be an *inadmissible* asset  
 in determining invested capital for excess profits tax purposes. This ruling  
 will supersede the ruling in Office letter of March 11, 1919. (Letter to The  
 Chase National Bank, New York, N. Y., signed by Commissioner Daniel  
 C. Roper, and dated March 13, 1919.)

**745** **War Finance Corporation Bonds as admissible and inadmissible**  
**assets.**—Bonds of the War Finance Corporation, the principal of  
 which does not exceed \$5,000, are inadmissible assets. Bonds of the War  
 Finance Corporation, the principal of which exceeds \$5,000 are admissible  
 assets. This ruling was issued by the Bureau of Internal Revenue today  
 in response to numerous inquiries as to whether such bonds are admissible  
 or inadmissible assets.

**746** “Inadmissible assets” is a term used in the Revenue Act of 1918 to  
 indicate certain assets of a corporation which may not be included  
 in calculating its invested capital.

**747** War Finance Corporation bonds are issued under the authority of  
 the Act of April 5, 1918, which provides that the interest on the  
 amount of such bonds, the principal of which does not exceed \$5,000 shall be  
 exempt from normal taxes, surtaxes, excess profits and war profits taxes,  
 and that the interest received by a taxpayer, independent of the amount of  
 his holdings, is exempt from normal Federal tax. (Official announcement  
 by the Bureau of Internal Revenue, April 5, 1919.)

**748** **Art. 816. Inadmissible Assets: Government Bonds.**—Obligations  
**552** of a State or Territory or any municipal or other political subdivision  
 thereof, of the District of Columbia, or of any possession of the  
 United States, and Federal farm loan bonds, not being obligations of the  
 United States within the meaning of the statute, are inadmissible assets.  
 See Section 213(b) of the Statute and Articles 74-82. (Art. 816, Reg. 45,  
 Rev., Jan. 28, 1921.)



**749 Art. 817. Inadmissible Assets: Partial Exception.**—(a) Where the  
 552 income derived from inadmissible assets consists in part of profit from the disposition thereof, or (b) where all or a part of the interest derived from such assets is in effect included in net income because the interest paid on indebtedness incurred or continued to purchase or carry such assets may not be deducted from gross income, in either case a corresponding part of the capital invested in such assets shall be deemed an admissible asset. This article applies separately to each issue or class of inadmissible securities held by a corporation. For example, it may hold A company stock costing \$100,000 and B company stock costing \$200,000. During the year it receives \$8,000 in dividends from A company and \$5,000 from B company, and on September 30 sells part of its B company stock at a profit of \$3,000. For the period from January 1 to September 30, \$75,000 of its holdings of B company stock became admissible. After September 30 its remaining holdings of B company stock are inadmissible, but the proceeds of the sale are admissible unless invested in inadmissibles. See articles 852 [for percentage of inadmissible assets, ¶805] and 854 [for computation of average invested capital, ¶807]. (Art. 817, Reg. 45, Rev., Jan. 28, 1921.)

**750 Art. 818. Admissible Assets.**—Admissible assets include all assets  
 553 other than inadmissible assets. Organization expenses and deferred charges against future income are admissible assets. For all purposes of computing invested capital admissible assets must be valued in accordance with the provisions of sections 326 [¶555], 330 [¶575], and 331 [¶579] of the statute and the articles thereunder. Thus, for example, intangible property paid in for stock or shares is an admissible asset, but it cannot be valued at an amount in excess of that at which it may be included in computing invested capital under paragraphs (4) [¶559] and (5) [¶560] of section 326(a). (Art. 818, Reg. 45, Rev., Jan. 28, 1921.)

### INVESTED CAPITAL. §326

**751 Art. 831. Meaning of Invested Capital.**—Invested capital within  
 555 the meaning of the statute is the capital actually paid in to the corporation by the stockholders, including the surplus and undivided profits, and is not based upon the present net worth of the assets, as shown by an appraisal or in any other manner. The basis or starting point in the computation of invested capital is found in the amount of cash and other property paid in, the valuation at which such other property may be included being determined in accordance with the statute and the regulations. The computation does not stop, however, with such original entries or amounts, but also takes into account the surplus and undivided profits of prior years left in the business. The invested capital of a corporation includes, generally speaking, (a) the cash paid in for stock, (b) the tangible property paid in for stock, (c) the surplus and undivided profits, and (d) the intangible property paid in for stock (to a limited amount), less, however, the same proportion of such aggregate sum as the amount of inadmissible assets bears to the amount of the admissible assets and the inadmissible assets held during the taxable year. Invested capital does not include borrowed capital. See section 325 of the statute and articles 811-818 [for terms relating to invested capital, beginning at ¶738]. The fair market value of the assets as of March 1, 1913, has no bearing on invested capital. (Art. 831, Reg. 45, Rev., Jan. 28, 1921.) [See ¶865 and ¶889.]

**752** **Original issue stock sold at par on commission in relation to invested capital.**—[Comment: The special ruling which appeared here, under the above heading, in the 1920 Service, was superseded by a special ruling which was reproduced at ¶870 in that Service. Such later ruling, holding that reasonable commissions or other forms of compensation lawfully paid by a corporation for sale of its capital stock are not to be deducted in computing invested capital, appears as 11-19-391: T. B. R. 40 under Section 326, Article 831, in the subjoined supplement containing the Bureau Rulings.—The Corporation Trust Company.]

**753** **Art. 832. Cash paid in: Bonus stock.**—Capital stock issued as a  
**556** bonus in connection with the sale of a corporation's bonds may not be included in invested capital unless the corporation proves to the satisfaction of the Commissioner that such stock bonus enabled the corporation to secure a higher price for the bonds than it could otherwise have secured. Wherever this fact is established such stock shall be included in computing invested capital to the extent of the difference between the selling price of the bonds and the price at which they could have been sold if issued without such stock bonus. The excess of the face value of such bonds over the price at which they could have been sold if issued without the stock bonus is deemed discount and is subject to amortization. See Article 39. (Art. 832, Reg. 45, Rev., Jan. 28, 1921.)

**754** **Art. 833. Tangible Property Paid in: Evidences of Indebtedness.**  
**557** —Enforcible notes or other evidences of indebtedness, either interest-bearing or non-interest bearing, of the subscriber received by a corporation upon a subscription for stock may be considered as tangible property in computing its invested capital to the extent of the actual cash value of such notes or other evidences of indebtedness at the time when paid in, but only (a) if such notes or evidences of indebtedness could under the laws of the jurisdiction in which the corporation was organized legally be received in payment for stock, and (b) if they were actually received by the corporation as absolute, and not as conditional, payment in whole or in part of the stock subscription. (Art. 833, Reg. 45, Rev., Jan. 28, 1921.)

**755** **Art. 834. Tangible Property Paid in: Inadmissible Assets.**—  
**557** Stocks, bonds and other obligations (other than obligations of the United States), the dividends or interest from which are not included in computing net income, when bona fide paid in for stock or shares may like other tangible property be included in computing the invested capital of the corporation at their actual cash value when paid in. For the purpose of the reduction required in articles 852 [¶805] and 854 [¶807] however, account must be taken of such assets in the same manner as of any other inadmissible assets. (Art. 834, Reg. 45, Rev., Jan. 28, 1921.)

**756** **Art. 835. Tangible Property Paid in: Mixture of Tangible and In-**  
**557** **tangible Property.**—Where stock or shares and bonds or other obligations have been issued for a mixed aggregate of tangible and intangible property, it will be presumed in the absence of satisfactory evidence to the contrary that the bonds were issued for tangible property and that the stock was issued for the balance of the tangible property, if



any, and for the intangible property. Where stock or shares have been issued for a mixed aggregate of tangible and intangible property and certain liabilities have been assumed in connection with the transaction, it will be presumed that such liabilities are to be charged against the tangible property and the intangible property in the order named, unless it is shown by evidence satisfactory to the Commissioner that this presumption is not in accordance with the facts. See further section 327 (c) [law §568] of the statute [and regulations §831]. (Art. 835, Reg. 45, Rev., Jan. 28, 1921.)

**757 Art. 836. Tangible Property Paid in: Value in Excess of Par Value of Stock.**—[For this Article 836 amended see §1265.] Evidence

offered to support a claim for a paid-in surplus must be as of the date of the payment, and may consist among other things of (a) an appraisal of the property by disinterested authorities made on or about the date of the transaction; (b) certification of the assessed value in the case of real estate; and (c) proof of a market price in excess of the par value of the stock or shares. The additional value allowed in any case is confined to the value definitely known or accurately ascertainable at the time of the payment. No claim will be allowed for a paid-in surplus in a case in which the additional value has been developed or ascertained subsequently to the date on which the property was paid in to the corporation, or in respect of property which the stockholders or their agents on or shortly before the date of such payment acquired at a bargain price, as for instance, at a receiver's sale. Generally, allowable claims under this article will arise out of transactions in which there has been no substantial change of beneficial interest in the property paid in to the corporation, and in all cases the proof of value must be clear and explicit. (Art. 836, Reg. 45, Rev., Jan. 28, 1921.)

**758 Tangible property paid in: Value in excess of par value of stock.**—

Reference is made to your letter of March 3, 1919, in regard to the — Coal Company, —, Kentucky, and it is noted that you desire a ruling as to the following facts: Mr. — secured a lease on a coal mine near —, Kentucky. It appeared that from the development and geographical condition of the country that the amount of coal this mine would produce would not exceed 500,000 tons. The — Coal Company was organized with a capital stock of \$75,000 and the lease secured by Mr. — was transferred to the corporation. Subsequent developments have proven that the mine will produce approximately 2,000,000 tons of coal. At the time of organization, the company was capitalized on the basis of the value of the coal known to be contained in the property. The company, therefore, desires to include in invested capital the increase in value of the property due to the discovery of the extraordinary large deposits of coal. In this connection your attention is called to Art. 836 [§757] of Reg. No. 45. (Letter to The Corporation Trust Company, signed by Commissioner Daniel C. Roper, dated March 11, 1919.)

**759 Depreciation of tangible property, added to invested capital as paid-in surplus, to be reflected in adjustment of earned surplus or undivided profits.**—Reference is made to your letter of March 18th, relative to paid-in surplus representing value of property in excess of the consideration paid therefor. ¶In reply you are informed that paid-in surplus representing tangible property need not be reduced by reason of depreciation of the property in question. All adjustments necessary on account of inadequate or excessive depreciation should be made in connection with earned

surplus or undivided profits. ¶Therefore, if a corporation is properly entitled to add to its invested capital in the form of paid-in surplus an amount representing excess in value of property, over the consideration paid therefor, either under Article 63 of Regulations No. 41, relative to the Revenue Act of 1917, or under Articles 836 [¶757] and 837 [¶760] of Regulations No. 45, relative to the Revenue Act of 1918, such paid-in surplus need not be reduced on account of depreciation of the property on which the excess value is claimed. ¶It should be borne in mind, however, that while paid-in surplus as indicated above, need not be reduced on account of depreciation, such adjustment must be made in earned surplus or undivided profits, and the computation must be based not on the cash paid or stock issued for the property but on its actual value at the time acquired for the purpose of computing the allowable addition to paid-in surplus. (Letter to Leslie, Banks & Company, New York, N. Y., signed by Commissioner Daniel C. Roper, and dated April 14, 1919.)

**760 Art. 837. Surplus and Undivided Profits: Paid-in Surplus.—**

558 Where it is shown by evidence satisfactory to the Commissioner that tangible property has been paid in by a stockholder to a corporation as a gift or at a value definitely known or accurately ascertainable as of the date of such payment clearly and substantially in excess of the cash or other consideration paid by the corporation therefor, then the amount of the excess shall be deemed to be paid-in surplus. Substantially the same kind of evidence will be required under this article as under article 836 [¶757]. See further article 813 [for amounts left in business by stockholders, as invested capital or borrowed capital, ¶740]. (Art. 837, Reg. 45, Rev., Jan. 28, 1921.)

**761 Art. 838. Surplus and Undivided Profits: Earned Surplus.—Only**

558 true earned surplus and undivided profits can be included in the computation of invested capital, and if for any reason the books do not properly reflect the true surplus such adjustments must be made as are necessary in order to arrive at the correct amount. In the computation of earned surplus and undivided profits full recognition must first be given to all expenses incurred and losses sustained from the original organization of the corporation down to the taxable year, including among such expenses and losses reasonable allowances for depreciation, obsolescence, or depletion of property (irrespective of the manner in which such property was originally acquired), and for the amortization of any discount on its bonds. There can, of course, be no earned surplus or undivided profits until any deficit or impairment of paid-in capital due to depletion, depreciation, expense, losses, or any other cause has been made good. Where adequate evidence is presented that the amounts written off or deducted in previous returns of net income are in the aggregate incorrect or unreasonable, adjustments must be made, and, if not barred by the statute of limitations, the taxpayer will be allowed a refund in respect of any taxes overpaid in prior years, or in the case of an underpayment of taxes will be additionally assessed. (Art. 838, Reg. 45, Rev., Jan. 28, 1921.)

**762 Art. 839. Surplus and Undivided Profits: Allowance for Depletion**

558 and Depreciation.—Depletion, like depreciation, must be recognized in all cases in which it occurs. Depletion attaches to each unit of mineral or other property removed, and the denial of a deduction



in computing net income under the Act of August 5, 1909, or the limitation upon the amount of the deduction allowed under the Act of October 3, 1913, does not relieve the corporation of its obligation to make proper provision for depletion of its property in computing its surplus and undivided profits. Adjustments in respect of depreciation or depletion in prior years will be made or permitted only upon the basis of affirmative evidence that as at the beginning of the taxable year the amount of depreciation or depletion written off in prior years was insufficient or excessive, as the case may be. Where deductions for depreciation or depletion have either on the books of the corporation or in its returns of net income been included in the past in expense or other accounts, rather than specifically as depreciation or depletion, or where capital expenditures have been charged to expense in lieu of depreciation or depletion, a statement indicating the extent to which this practice has been carried should accompany the return. (Art. 839, Reg. 45, Rev., Jan. 28, 1921.)  
*[In connection with the foregoing read at ¶877.]*

**763 Allowance for amortization under the Munitions Manufacturer's Tax Law will not affect computation of invested capital for taxable year 1918.**—Reference is made to your letter in which you request a ruling on behalf of your client, with regard to whether amounts deducted as allowances for amortization on munitions tax returns for 1916 and 1917 should be included in the computation of invested capital for 1918, or should be made the subject of adjustments in the nature of deductions from invested capital.

¶In reply you are advised that the Munition Manufacturer's tax was laid "upon the entire *net profits* actually received or accrued," from the sale or disposition of specific munitions, and it was provided in Section 302 "That in computing net profits under the provisions of this title, for the purpose of the tax there shall be allowed as deductions from the gross amount received or accrued for the taxable year from the sale or disposition of such articles manufactured within the United States, the following items: \* \* \*

(f) A reasonable allowance according to the conditions peculiar to each concern, for amortization of the values of building and machinery, account being taken of the exceptional depreciation of special plants." ¶It is apparent from this language that the amortization allowance in question was authorized for the purpose of computing "net profits," not net "income." The right to make a deduction for amortization in computing net income for the income tax did not exist and was repeatedly denied by the Bureau prior to the passage of the Revenue Act of 1918. It is to be noted further that the taxes imposed by Title II of the Revenue Act of 1917 and Title III of the Revenue Act of 1918 were explicitly laid upon "net income," and were in a variety of ways impressed with the stamp and character of an income rather than a munition manufacturer's tax. They are in no sense mere continuations or expansions of the tax imposed by Title III of the Revenue Act of 1916. It follows, therefore, that the deduction for amortization under the Munition Manufacturer's Tax law was not allowed for income tax purposes and should not now be permitted to affect the surplus or any other element entering into the "invested capital" employed for purposes of the war-profits and excess-profits taxes. ¶This conclusion is supported by the character of the amortization allowance in question. It was in many respects quite dissimilar from the depreciation and depletion allowances. It was not based upon the fact that plant and equipment acquired in the year 1916 or earlier for the manufacture of munitions, actually depreciated in use or market value during the taxable year 1916. There was in general no such depreciation in value or impairment of useful life. Account was taken "of the

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exceptional depreciation of special plants" but the principal allowance was "for the amortization of the values of buildings and machinery," whether those values increased or decreased in the immediate future. The principal amortization allowance looked to the establishment of a special fund to recoup exceptional war costs when war uses had ceased; it did not imply that there had been or would be any immediate impairment of physical assets, such as is covered by the depletion allowance, or any immediate exhaustion, wear, tear or obsolescence in excess of the amount covered by the depreciation allowance. It was, as stated, a special allowance peculiar to this tax, designed possibly to moderate the (then) exceptionally high rates, of the Munition Manufacturer's Tax. ¶Reference has been made in this connection to the wording of Section 214 (a) (9) and Section 234 (a) (8) authorizing a deduction for amortization under the Revenue Act of 1918; but upon careful examination these paragraphs are found to have no bearing upon the present case. ¶It is held, therefore, that the amount deducted as an allowance for amortization under the Munitions Manufacturer's Tax Law will not affect the computation of invested capital for the taxable year 1918. (Letter to a subscriber, signed by Commissioner Daniel C. Roper, and dated August 13, 1919.)

**764 Art. 840. Surplus and Undivided Profits: Additions to Surplus**  
**558 Account.**—A corporation's books of account will be presumed to show the facts. If it claims that its capital or surplus account is understated the burden of proof will rest upon it. Additions to such accounts will be accepted to the following extent:

**765** (1) Excessive depreciation heretofore charged off on property still owned and in use, if it is now shown by satisfactory proof to have been excessive and such excess is substantial in amount, whether or not disallowed by the Commissioner as a deduction from net income, may be restored to the surplus account. No such amount shall be restored, however, unless it is shown that adequate depreciation has been deducted upon all other property of the corporation still in use, nor in any case in which such amount has been allowed as a deduction for amortization under section 234 (a) (8) of the statute, or in which the cost of the property has been recovered through being included in the price of goods or services, as for example, in the case of patterns, dies, plates, special tools, etc., or under a munition contract with a foreign government.

**766** (2) Amounts which have been expended before January 1, 1917, for the acquisition of plant, equipment, tools, patterns, furniture, fixtures, or like tangible property, having a useful life extending substantially beyond the year in which the expenditure was made, and which have been charged as current expense, may (less proper deductions for depreciation or obsolescence) be added to the surplus account when such assets are still owned and in active use by the corporation during the taxable year. Special tools, patterns, and similar assets shall not be assigned any value if their cost has been recovered through having been included in the price of goods. If their cost has not been so recovered and they are held for only occasional use, they shall not be assigned a value in excess of the fair value based upon the earnings actually arising from their current use, and in no case shall such value be more than the cost less depreciation. Assets of this kind not in current use shall not be valued at more than their nominal or scrap value.

**767** (3) Amounts which have been expended in the past for intangible property of any kind can be restored to capital or surplus account only to the extent that the corporation specifically paid such amounts for

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the intangible property as such. For provisions relating to patents see article 843.

**768** (4) Adjustments necessary to correct other errors found in the books of account may be made. But see the following article. (Art. 840, Reg. 45, Rev., Jan. 28, 1921.)

**769** **Art. 841. Surplus and Undivided Profits: Limitation of Additions**  
**558** **to Surplus Account.**—Additions to surplus which a corporation may desire to make under the preceding article fall broadly into two classes:

**770** (1) To correct returns of net income for prior years in which actual errors have been made, as for example where excessive depreciation has been deducted, additions to plant and equipment or other capital charges have been charged off as an expense, inventories have been taken upon a wrong basis of valuation, etc.

**771** (2) To reinstate in surplus deductions from income which are as a matter of good accounting to some extent optional, such as experimental expenses, patent litigation, development of good will through advertising or otherwise, etc. [See ¶1926.]

**772** Adjustments falling in class (1) will be permitted for all years whether before or after March 1, 1913, provided amended returns of net income are filed for each year in which an erroneous return has been made. Due consideration will be given to the assessment of penalties in any case in which a fraudulent return has been made. Adjustments falling in class (2) cannot be permitted, as in such cases it is considered that the corporation has exercised a binding option in deducting such expenses from income. An election of this sort which was made concurrently with the transaction cannot now be revised, and amended returns in respect thereof cannot be accepted. The corporation shall submit with its return a statement of the additions proposed, specifying the kinds and amounts of property involved, the years in which the expenditures were made, and the method followed in distinguishing between capital outlays and current expenses, and showing that adequate provision has been made for depreciation, obsolescence and depletion of such of the assets affected by the additions as are subject to recognized depreciation, obsolescence or depletion. In any case in which there is an operating deficit amounts restored must first be set off against the deficit and only the excess can be actually included in the computation of invested capital (Art. 841, Reg. 45, Rev., Jan. 28, 1921.) [See ¶1926.]

**773** **Art. 842. Surplus and Undivided Profits: Property Paid in and Subsequently Written off.**—Where tangible or intangible property has been paid in to a corporation for stock or shares or as paid-in surplus and has subsequently been in whole or in part written off the books, the amount so written off may upon evidence satisfactory to the Commissioner be restored to the capital or surplus account subject to the following limitations:

**774** (1) The amount restored must be reduced by a proper deduction for any depreciation, obsolescence, or depletion; and

**775** (2) The aggregate amount included in computing invested capital on account of such property shall not exceed the amount which might have been included if such property had not been written off. (Art. 842, Reg. 45, Rev., Jan. 28, 1921.)

**776 Art. 843. Surplus and Undivided Profits: Patents.**—From the  
 558 standpoint of assets a patent, or more particularly a group of patents, is closely analogous to good will. Their value is contingent upon and measured by their earning power. While patents have a definite life, there is a common tendency to extend that life by improvements upon the original, and in a successful business the patent value merges more or less completely into a trade name or other form of good will. Therefore, while deductions in respect to the depreciation of patents based upon a normal life period of seventeen years are allowable in computing net income for the purpose of the income tax, such deductions are not obligatory, but are optional with each taxpayer. Where since January 1, 1909, a corporation has exercised that option to its own benefit in computing its taxable net income the amount so deducted can not now be restored in computing invested capital. Where, however, the cost of patents has been charged against surplus or otherwise disposed of in such a manner as not to benefit the corporation in computing its taxable net income since January 1, 1909, any amount so written off may be restored in computing invested capital, if it be shown to the satisfaction of the Commissioner that the amount so written off represented a mere book entry ascribable to a conservative policy of management or accounting and did not represent a realized shrinkage in the value of such assets. Any amount so restored may not be written off by way of deductions from taxable net income in any subsequent year or years. Where a corporation has charged to current expenses the cost of developing or protecting patents, no amount in respect thereof expended since January 1, 1909, can be restored in computing invested capital. In respect of expenditures made before January 1, 1909, a corporation now seeking to restore them must be prepared to show to the satisfaction of the Commissioner that all such items are proper capital expenditures. It can not be said that the correct computation of surplus and undivided profits necessarily requires a deduction in respect of the expiration of patents. It follows, therefore, that where a corporation in the exercise of its option has not written down the cost of patents, it is not ordinarily necessary to reduce the surplus and undivided profits in computing invested capital, whether the patents have been acquired for stock or shares or for cash or other tangible property. Due consideration will be given to the facts in any case in which this rule seems obviously unreasonable. See article 167. (Art. 843, Reg. 45, Rev., Jan. 28, 1921.)

**777 Blank.**

**778 Art. 844. Surplus and Undivided Profits: Reserve for Depreciation or Depletion.**—If any reserves for depreciation or for depletion are included in the surplus account it should be analyzed so as to separate such reserves and leave only real surplus. Reserves for depreciation or depletion can not be included in the computation of invested capital, except to the following extent:

**779** (1) Excessive depletion or depreciation included therein and which if charged off could be restored under article 840 [764] may be included in the computation of invested capital; and

**780** (2) Where depreciation or depletion is computed on the value as of March 1, 1913, or as of any subsequent date, the proportion of depreciation or depletion representing the realization of appreciation of



value at March 1, 1913, or such subsequent date, may if undistributed and used or employed in the business be treated as surplus and included in the computation of invested capital.

**781** For the purpose of computing invested capital depreciation or depletion computed on the value as of March 1, 1913, or as of any subsequent date shall, if such value exceeded cost, be deemed a pro rata realization of cost and appreciation and be apportioned accordingly. Except as above provided value appreciation (even though evidenced by an appraisal) which has not been actually realized and in respect of amounts accrued since March 1, 1913, reported as income for the purpose of the income tax, can not be included in the computation of invested capital, and if already reflected in the surplus account it must be deducted therefrom. (Art. 844, Reg. 45, Rev., Jan. 28, 1921.)

**782** **Art. 845. Surplus and Undivided Profits: Reserve for Income and**  
**558 Excess Profits Taxes.**—For the purpose of computing invested capital federal income and war profits and excess profits taxes are deemed to have been paid out of the net income of the taxable year for which they are levied. It is immaterial, therefore, whether reserves for the payment of such taxes for the preceding year have been set up or not, or if set up whether such taxes when paid have actually been charged against such reserves. Amounts payable on account of such taxes for the preceding year may be included in the computation of invested capital only until such taxes become due and payable. A deduction from the invested capital as of the beginning of the taxable year must therefore be made for such taxes or any installment thereof, averaged for the proportionate part of the taxable year after date when the tax or the installment is due and payable. Where as a result of an audit by the Commissioner, or the acceptance of an amended return, or for any other reason, the amount of any such tax for the preceding year is subsequently changed, a corresponding adjustment will be made in the invested capital for the taxable year upon the same basis as if the corrected amount of the tax for the preceding year had been used in the original computation of the invested capital for the taxable year. (Art. 845, Reg. 45, Rev., Jan. 28, 1921.)

**783** **Art. 845 (a). Surplus and undivided profits: Reserve for 1918**  
**income and excess profits taxes of corporations having a fiscal year.**  
 —In case of corporations having a fiscal year, the Federal income and profits taxes for the taxable year 1918 shall, for the purpose of computing invested capital for the taxable year 1919 be deemed to become due and payable as follows: (a) As to such amounts as became due and payable prior to February 25, 1919, under the provisions of Section 14 (a), Revenue Act of 1916, such law shall govern; (b) in all other respects the provisions of Section 250 of the Revenue Act of 1918 shall govern except that the installments which would become due prior to February 25, 1919, shall be deemed to become due and payable on that date; (c) Any amounts which became due and payable under said Section 14 (a) prior to February 25 shall, so far as possible, be deemed to cancel earlier installments payable under said section 250. For example, a corporation whose fiscal year ended August 31, 1918, is assessed a total income and profits tax under the 1917 law of \$250,000 and an additional tax under the 1918 law of \$110,000. The total tax of \$360,000 would, for the purpose of computing invested capital, be deemed to become due and payable as follows: February 12, 1919,

\$250,000; May 15, 1919, \$20,000; August 15, 1919, \$90,000. If, assuming the same taxes, the fiscal year ended September 30, 1918, the total tax would for the purpose of computing invested capital, be deemed to become due and payable as follows: February 25, 1919, \$90,000; March 15, 1919, \$90,000; June 15, 1919, \$90,000; September 15, 1919, \$90,000. The provisions of this article apply solely for the purpose of computing invested capital and do not affect the provisions of T. D. 2797 in regard to the time and manner of paying taxes where corporations have filed returns for fiscal years ending in 1918. (Art. 845 (a), Reg. 45, Rev., Jan. 28, 1921.)

#### 784 Blank.

**785** Installment due-and-payable dates govern in apportioning reserves for taxes for invested capital purposes.—“¶ In the preparation of 1919 corporation tax returns we would like to know if we will be permitted in the computation of invested capital under schedule “H,” Form 1120, to compute our taxes as having been paid in quarterly installments, or, will we be forced to deduct from invested capital the full amount of taxes paid on the date remitted to the collector?”

**786** In reply you are advised that the date when the 1918 taxes were actually paid has no bearing on the computation of the invested capital of the corporation for the year 1919, inasmuch as the controlling factor is the date when such taxes were “due and payable,” and not the date when they were actually paid. In other words, the amount of each installment of the tax for 1918 will remain a part of the invested capital for 1919 until such installment is due and payable, and when such installment is due, an adjustment should be made in the nature of a deduction from invested capital under Schedule H (d), on page 5, of Form 1120-A. (Letter to Simon Bros., Ltd., Alexandria, La., signed by P. S. Talbert, Acting Assistant to the Commissioner, by C. R. Trobridge, Acting Head of Division, and dated September 22, 1919, made available through the courtesy of Cox and Flournoy, Alexandria, La.)

#### **787** Art. 846. Surplus and undivided profits: Insurance on officers.—

**558** Where insurance is carried by the corporation on the life of an officer or employee, the policy may be included as an admissible asset and reflected in the surplus account at the cash surrender value as of the beginning of the taxable year. The whole amount of premiums paid on such insurance can not be included in surplus, but the surplus will be considered as increased as of the beginning of each taxable year by the amount added to the cash surrender value of the policy. (Art. 846, Reg. 45, Rev., Jan. 28, 1921.)

#### **788** Art. 847. Surplus and undivided profits: Property taken for debt

**558** or in exchange.—Real or personal property taken by a corporation in payment or satisfaction of a debt, or property received in exchange for other property, will be an admissible asset at its fair market value upon receipt. The profit or loss, if any, resulting from the transaction will not be reflected in invested capital until the succeeding taxable year. But see as to the foreclosure of a mortgage article 153. See also section 202 of the statute and articles 1561-1570. (Art. 847, Reg. 45, Rev., Jan. 28, 1921.)

#### 789 Blank.



**790 Art. 848. Surplus and undivided profits: Discount on sale of bonds.**

**558** —Discount allowed on the sale of bonds is in effect an advance on account of interest, so that the effective rate of interest in such a case is equal to the sum of the nominal rate plus the rate necessary to amortize the discount over the life of the bonds. Where, under incorrect accounting practices, the discount on bonds has been charged to a property account or otherwise carried as an asset, and is so reflected in the surplus account, it is necessary in computing invested capital to make an adjustment in respect of such discount. See article 563. (Art. 848, Reg. 45, Rev., Jan. 28, 1921.)

**791 Art. 849. Surplus and undivided profits: Miscellaneous.—Only**

**558** the amount of discount which has actually been reported by a bank in a prior year as taxable income and credited to surplus account may be included in surplus as of the beginning of the taxable year. For the treatment of surplus arising out of sales on the installment plan see articles 42-46, and from compensation for property lost, damaged, or condemned, see articles 49 and 50. (Art. 849, Reg. 45, Rev., Jan. 28, 1921.)

**792 to 802 Blank.**

**803 Art. 850. Surplus and Undivided Profits: Current Profits.—Profits**

**558** earned during any year can not be included in the computation of invested capital for that year, even though during the year such profits are set up as surplus on the books or assumed to be distributed in the form of stock dividends. If a dividend is declared and paid during any year out of the profits of that year and the stockholders pay back into the corporation all or a substantial part of the amount of such dividends, the amount so paid back can not be included in the computation of invested capital unless the corporation shows by evidence satisfactory to the Commissioner that the dividends were paid in good faith and without any understanding, express or implied, that they were to be paid back. (Art. 850, Reg. 45, Rev., Jan. 28, 1921.)

**804 Art. 851. Intangible Property Paid In.—The actual cash value of**

**559** intangible property paid in for stock or shares must be determined  
**560** in the light of the facts in each case. Among the factors to be considered are (a) the earnings attributable to such intangible assets while in the hands of the predecessor owner; (b) the earnings of the corporation attributable to the intangible assets after the date of their acquisition; (c) representative sales of the stock of the corporation at or about the date of the acquisition of the intangible assets; and (d) any cash offers for the purchase of the business, including the intangible property, at or about the time of its acquisition. A corporation claiming a value for intangible property paid in for stock or shares should file with its return a full statement of the facts relating to such valuation. See also article 835 [for mixture of tangible and intangible property paid in, ¶756]. (Art. 851, Reg. 45, Rev., Jan. 28, 1921.)

**805 Art. 852. Percentage of Inadmissible Assets.—For the purpose of**

**562** ascertaining the deductible percentage the amount of inadmissible assets held during the year may ordinarily be determined by dividing by two the sum of the amount of such assets held at the beginning of the year and the amount held at the end of the year. The total amount of ad-

missible and in admissible assets held during the year may ordinarily be determined by dividing by two the sum of the amount of such assets held at the beginning of the year and the amount at the end of the year. If at any time a substantial change has taken place either in the amount of inadmissible assets or in the total amount of admissible and inadmissible assets, the effect of such change shall be averaged exactly from the date on which it occurred. In any case where the Commissioner finds that either amount determined as above provided does not substantially reflect the average situation throughout the year, and that the amount of each kind of assets held on a given day of each month throughout the year or at more frequent regular intervals can be determined, the amount of inadmissible assets and the amount of both kinds of assets held during the year shall be determined by averaging the amounts held at such several times. In making the computations under this article the valuation at which each asset is carried shall be adjusted in accordance with the provisions of the statute and of the regulations relating to the valuation of assets for the purpose of computing invested capital, including in such adjustment the amount of reserves for depreciation, depletion, amortization and other reserves which represent the valuation of assets. It is immaterial whether any asset was acquired out of invested capital or out of profits earned during the year or borrowed capital. (Art. 852, Reg. 45, Rev., Jan. 28, 1921.)

**806**    **Art. 853. Changes in Invested Capital During Year.**—The invested capital as of the beginning of any period of one year or less should be adjusted by an appropriate addition or deduction for each change in invested capital during the period. The amount so added or deducted in each case is the amount of the change averaged for the time remaining in the period during which it is in effect. The fraction used in finding such average is the number of days remaining in the period (including the day on which the change occurs) over the number of days in the period. Thus if a return is made for the calendar year ending December 31, 1918, and if \$100,000 of additional capital was paid in on February 17, 1918, this addition to invested capital is in effect for 318 days, and the amount to be added to the invested capital as of the beginning of the year would be  $318/365$  of \$100,000, or \$87,123.29. If \$50,000 of this amount was withdrawn on October 31, 1918, the amount to be deducted would be  $62/365$  of \$50,000, or \$8,493.15. (Art. 853, Reg. 45, Rev., Jan. 28, 1921.)

**807**    **Art. 854. Computation of Average Invested Capital.**—For the purpose of computing invested capital for any period of one year or less each corporation shall add together its paid-in capital and its paid-in or earned surplus and undivided profits (under whatever name it may be called) as shown by its books at the beginning of the period. The total so obtained shall be adjusted (a) for any property paid in, or for any asset reflected in surplus and undivided profits, which is not carried on the books at the valuation prescribed by the statute or by the regulations, and (b) for any changes in paid-in capital or in paid-in or earned surplus and undivided profits (not including surplus and undivided profits earned during the period) occurring during the period, averaged for the time for which such changes are effective. See article 853 [for changes in invested capital during year, ¶806]. The total so obtained and adjusted is the average invested capital for the period, unless the corporation at any time during the period held any



inadmissible assets, in which case such total must be reduced by a percentage thereof equal to the percentage which the amount of inadmissible assets held during the period is of the total amount of admissible and inadmissible assets held during the period. See article 852 [¶805]. The invested capital for any year during the prewar period is determined in the same manner as for the taxable year. The invested capital can not be determined by adding the amounts of the assets of a corporation. (Art. 854, Reg. 45, Rev., Jan. 28, 1921.)

**808 Art. 855. Invested Capital for Full Year or Less.**—In the case of a corporation making a return for a full year of 12 months, its invested capital for the year is the average invested capital for the year. In the case of a corporation making a return for a fractional part of a year, its invested capital for such period is the same fractional part of the average invested capital for such period, except that for the purpose of section 311 (a) (2) [computation of war-profits credit, ¶532] of the statute it is the full average invested capital for the period. In computing the tax under a return for a fractional part of a period the same purpose may sometimes be more readily effected by using the full average invested capital and taking a fractional part of the result, as in schedule III of form 1120, used for 1918. In schedule IV of the same form, however, the fractional part of the full average invested capital for the period should be used. See articles 720 [for illustration of computation, ¶634] and 853 [for changes in invested capital during year, ¶806]. (Art. 855, Reg. 45, Rev., Jan. 28, 1921.)

**809 Art. 856. Illustration of Invested Capital for Fractional Part of Year.**—A corporation was organized July 1, 1918, and makes a return for the six months ending December 31, 1918. The invested capital consists of \$100,000 paid in on July 1 and \$100,000 paid in on October 1. The average invested capital for such period would be \$100,000 plus  $92/184$  (not  $92/365$ ) of \$100,000, or \$50,000, a total of \$150,000. The invested capital for the period for the purpose of the tax would, however, be  $6/12$  of \$150,000, or \$75,000. But see section 311 (a) (2) of the statute [for computation of war-profits credit, ¶532]. (Art. 856, Reg. 45, Rev., Jan. 28, 1921.)

**810 Art. 857. Method of Determining Available Net Income.**—  
**558** Whether at the time of any payment made during the taxable year there is sufficient income of the taxable year available for such payment, or whether the surplus or undivided profits as of the beginning of the taxable year must be reduced by the amount of such payment shall be determined according to the following principles:

**811** (1) The aggregate amount of earnings of the taxable year available for all purposes up to any given date will be determined upon the basis of the same proportion of the net income for the taxable year (as finally determined for the purpose of income and war profits and excess profits taxes) as the part of the year already elapsed is of the entire year (determined in the manner provided in article 853 [¶806]), unless the corporation shows from its books or other records that a greater proportion of its earnings for the year was available on such date.

**812** (2) The aggregate amount available will be deemed to be applied for the following purposes in the order in which they are stated:  
(a) accrued federal income and war profits and excess profits taxes for the

taxable year (see article 845 [¶782]), and (b) dividends paid after the expiration of the first sixty days of the taxable year (see section 201 of the statute [law ¶505] and article 1541 [Income Tax Service]) and other corporate purposes, including the purchase of outstanding stock of the corporation previously issued (see article 862 [¶817]). In any case where the above computation would be indeterminate because of the effect of the provisions of this article upon the invested capital for the year, the amount of such invested capital for the purpose of this computation may be deemed to be the invested capital as of the beginning of the taxable year, plus any additional capital paid in during such year and minus any specific withdrawal or liquidation of capital during such year. (Art. 857, Reg. 45, Rev., Jan. 28, 1921.)

**813 Art. 858 Effect of Ordinary Dividend.**—A dividend other than a  
558 stock dividend affects the computation of invested capital from the date when the dividend is payable and not from the date when it is declared, except that where no date is set for its payment the date when declared will be considered also the date when payable for the purpose of this article. For the purpose of computing invested capital a dividend paid after the expiration of the first sixty days of the taxable year will be deemed to be paid out of the net income of the taxable year to the extent of the net income available for such purpose on the date when it is payable. See article 857, [¶810]. The surplus and undivided profits as of the beginning of the taxable year will be reduced as of the date when the dividend is payable by the entire amount of any dividend paid during the first sixty days of the taxable year and by the amount of any other dividend in excess of the current net income available for its payment. In the case of a dividend paid during the first sixty days of a taxable year which exceeds in amount the surplus and undivided profits as of the beginning of the taxable year the excess will be deemed to be paid out of earnings of the taxable year available at the date when the dividend is payable, and to the extent that such earnings are insufficient it will be deemed to be a liquidation of paid-in capital or surplus. From the date when any dividend is payable the amount which the several stockholders are entitled to receive will be treated as if actually paid to them, whether or not it is so paid in fact, and the surplus and undivided profits, either of the taxable year or of the preceding years, will in accordance with the foregoing provisions be deemed to be reduced as of that date by the full amount of the dividend. Amounts paid to stockholders in anticipation of dividends, or amounts withdrawn by stockholders in excess of dividends declared, will in computing invested capital have the same effect as if actually paid as dividends. See also article 813 [for amounts left in business by stockholders, ¶740], and see generally section 201 [for dividends, ¶505] and articles 1541-1549 [for taxable status of dividends generally]. (Art. 858, Reg. 45, Rev., Jan. 28, 1921.)

**814 Art. 859. Effect of Stock Dividend.**—Neither the payment nor the receipt of a true stock dividend has any effect upon the amount of invested capital. Such items as appraised value of good will, appreciation in value of real estate or other tangible property, etc., although carried to surplus and distributed as stock dividends, can not in this manner be capitalized and included in computing invested capital. If a corporation has paid a stock dividend in excess of its true surplus, it can not be deemed to have any greater invested capital than could have been computed had



no such stock dividend been paid. (Art. 859, Reg. 45, Rev., Jan. 28, 1921.) [See ¶889.]

**815** Art. 860. **Impairment of Capital.**—Capital or surplus actually paid  
556 in is not required to be reduced because of an impairment of capital in the nature of an operating deficit, except where there has been directly or indirectly a liquidation or return of their investment to the stockholders, in which case full effect must be given to any liquidation of the original capital. (Art. 860, Reg. 45, Rev., Jan. 28, 1921.)

**816** Art. 861. **Surrender of Stock.**—Where stock which has originally  
556 been issued or exchanged by the corporation for property (tangible or intangible) is returned to the corporation as a gift or for a consideration substantially less than its par value, the stock so returned shall not be treated as a part of the stock issued or exchanged for such property. The proceeds derived in cash or its equivalent from the resale of the stock so returned shall, however, be included in computing invested capital. See article 542. (Art. 861, Reg. 45, Rev., Jan. 28, 1921.)

**817** Art. 862. **Purchase of Stock.**—Where a corporation either di-  
556 rectly or indirectly, as for example through a trustee, has prior to the taxable year bought its own stock, either for the purpose of retirement or of holding it in the treasury or for other purposes, the entire cost of such stock must be deducted from the aggregate invested capital as of the beginning of the taxable year, if such deduction has not already been made. Where such stock is purchased during the taxable year a deduction from the invested capital as of the beginning of the taxable year and effective from the date of such purchase is required only to the extent that such stock has not been purchased out of the undivided profits of the taxable year. See article 857 [for method of determining available net income, ¶810]. The full amount derived in cash or its equivalent from the resale of such stock may be included in the invested capital from the date of such resale, unless such stock had been purchased out of earnings of the taxable year. See article 542. (Art. 862, Reg. 45, Rev., Jan. 28, 1921.)

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**820** Art. 863. **Invested Capital and other Measures of Capital.**—(a) The  
invested capital as here defined may differ from the capital as shown on the books of the corporation. In such event no changes should be made in the books themselves. The corporation should, however, in all cases keep a permanent record of the adjustments which are made in computing invested capital. (b) Section 1000 of the statute imposes a tax on the fair value of the capital stock of corporations [Capital Stock Tax, ¶3000 herein]. As in the case of the war profits and excess profits tax the invested capital is based upon the actual investment of the stockholders in the corporation, irrespective of the present value of its assets, and in the case of the capital stock tax the fair value looks to the present value of the corporation's assets, irrespective of the amount of the investment of the stockholders therein, the amount determined as the fair value of the capital stock for the purpose of the capital stock tax can have no bearing upon the determination of invested capital. See also article 1561 [or articles 831, ¶751, for statement that "the fair market value of the assets as of March 1, 1913, has no bearing on invested capital"]. (Art 863, Reg. 45, Rev., Jan. 28, 1921.)

**821 Art. 864. Affiliated corporations: Invested capital.**—The invested  
 587 capital of affiliated corporations, as defined in section 240 (b) of the statute [law ¶589] and article 633 for the taxable year is the invested capital of the entire group treated as one unit operated under a common control. As a first step in the computation a consolidated balance sheet should be prepared in accordance with standard accounting practices, which will reflect the actual assets and liabilities of the affiliated group. In preparing such a balance sheet all intercompany items, such as intercompany notes and accounts receivable and payable, should be eliminated from the assets and the liabilities, respectively, and proper adjustments should be made in respect of intercompany profits or losses reflected in inventories which at the beginning or end of the taxable year contain merchandise exchanged between the corporations included in the affiliated group at prices above or below cost to the producing or original owner corporation. Such consolidated balance sheet will then show (a) the capital stock of the parent or principal company in the hands of the public; (b) the consolidated surplus belonging to the stockholders of the parent or principal company; and (c) the capital stock, if any, of subsidiary companies of which substantially all the capital stock is not owned or controlled by the parent or principal company, together with the surplus, if any, belonging to such minority interest. In computing consolidated invested capital the starting point is furnished by the total of the amounts shown under (a), (b), and (c) above. This total must be increased or diminished by any adjustments required to be made under the provisions of sections 325, 326, 330, and 331 of the statute and articles 811-818, 831-869, 931-934, and 941 of the regulations, except as otherwise provided in articles 865-868. (Art. 864, Reg. 45, Rev., Jan. 28, 1921.)

**822 Blank.**

**823 Art. 865. Affiliated Corporations: Intangible Property Paid In.**—

587 (1) In respect of corporations whose affiliation is in the nature of parent and subsidiary companies: (a) in the case of intangible property bona fide paid in for stock or shares prior to March 3, 1917, there may be included in invested capital an amount not exceeding the actual cash value of such property at the time paid in, or the par value of the stock or shares issued therefor, or in the aggregate 25 per cent of the par value of the total stock or shares of the consolidation outstanding on March 3, 1917 (determined as indicated in items (a) and (c) in article 864 [¶821]), or in the aggregate 25 per cent of the par value of the total stock or shares shown on the consolidated balance sheet, being the amount of the capital stock included in items (a) and (c) in article 864 [¶821] at the beginning of the taxable year, whichever is lowest; and (b) in the case of intangible property bona fide paid in for stock or shares on or after March 3, 1917, there may be included in invested capital an amount not exceeding the actual cash value of such property at the time paid in, or the par value of the stock or shares issued therefor, or in the aggregate 25 per cent of the par value of the total stock or shares shown by the consolidated balance sheet, being the amount of the capital stock included in items (a) and (c) in article 864 [¶821] outstanding at the beginning of the taxable year, whichever is lowest. (c) When intangible property has been acquired in part before and in part after March 3, 1917, the amounts shall be ascertained, respectively, under (a) and (b) above and in the aggregate shall in no case exceed 25 per cent of the par value of the total stock or shares outstanding at the beginning of the taxable year



shown in the consolidated balance sheet, being the amount of the capital stock included in items (a) and (c) in article 864 [¶821].

**824** (2) In respect of corporations affiliated by reason of stock ownership  
**587** or control by the same interests, the limitations set forth in paragraphs (4) [¶559] and (5) [¶560] of subdivision (a) of section 326 of the statute shall be applied to each corporation separately and the aggregate of the intangible property, so valued, shall be included in invested capital in the consolidated return. In respect of each of the affiliated corporations the aggregate of the amounts ascertained under the provisions of paragraphs (4) [¶559] and (5) [¶560] shall in no case exceed 25 per cent of the outstanding capital stock of such corporation at the beginning of the taxable year. (Art. 865, Reg. 45, Rev., Jan. 28, 1921.)

**825** Art. 866. Affiliated Corporations: Inadmissible Assets.—Where  
**587** adjustment is required in respect of inadmissible assets in accordance with the provisions of subdivision (c) [¶562] of section 326 of the statute, such adjustment shall be made on the basis of the consolidated balance sheet with due regard to the adjustments and eliminations set forth in articles 864 [¶821] and 865 [¶823] and to the provisions of articles 815-818 [beginning at ¶743]. (Art. 866, Reg. 45, Rev., Jan. 28, 1921.)

**826** Art. 867. Affiliated Corporations: Stock of Subsidiary Acquired  
**587** for Cash.—When all or substantially all of the stock of a subsidiary corporation was acquired for cash, the cash so paid shall be the basis to be used in determining the value of the property acquired. (Art. 867, Reg. 45, Rev., Jan. 28, 1921.)

**827** Art. 868. Affiliated Corporations: Stock of Subsidiary Acquired for  
**587** Stock.—Where stock of a subsidiary company was acquired with the stock of the parent company, the amount to be included in the consolidated invested capital in respect of the company acquired shall be computed in the same manner as if the net tangible assets and the intangible assets had been acquired instead of the stock. If in accordance with such acquisition a paid-in surplus is claimed, such claim shall be subject to the provisions of article 837 [¶760]. (Art. 868, Reg. 45, Rev., Jan. 28, 1921.)

**828** Art. 869. Affiliated Corporations: Invested Capital for Prewar  
**587** Period.—The invested capital of affiliated corporations for the prewar period shall be computed on the same basis as the invested capital for the taxable year, except that where any one or more of the corporations included in the consolidation for the taxable year were in existence during the prewar period, but were not then affiliated as herein defined, then the average consolidated invested capital for the prewar period shall be the average invested capital of the corporations which were affiliated in the prewar period plus the aggregate of the average invested capital for each of the several corporations which were not affiliated during the prewar period. Full recognition, however, must be given to the provisions of section 330 of the statute [¶575], particularly the last paragraph thereof [¶578], and of articles 931-934 [beginning at ¶837: all having to do with reorganizations]. (Art. 869, Reg. 45, Rev., Jan. 28, 1921.)

**829** Art. 870. Insurance Companies.—The reserve funds of life insurance  
**551** companies, the net additions to which are deductible from gross income under the provisions of Section 234 of the statute, can not be  
**561** included in computing invested capital. The like reserve funds of

insurance companies, other than life insurance companies, may be included in computing invested capital. See Sections 325 and 326 (a) (3) and (b) and Articles 569 and 814 [¶742]. (Art. 870, Reg. 45, Rev., Jan. 28, 1921, as amended by T. D. 3153, April 9, 1921.)

**830** Art. 871. Foreign Corporations.—Inasmuch as the war profits and  
565 excess profits tax in the case of a foreign corporation is not based on  
567 the invested capital of the corporation, but is computed in accordance with section 328 of the statute [See ¶832], the provisions of section 326 [law ¶555] and of articles 831-870 [having to do with invested capital, beginning at ¶751] have no application to foreign corporations. For the same reason, when rendering a return of income on form 1120 for a foreign corporation, no entry of invested capital should be made thereon. See article 962 [for returns by foreign corporations, ¶852]. (Art. 871, Reg. 45, Rev., Jan. 28, 1921.)

### SPECIAL CASES. §327

**831** Art. 901. Treatment of special cases.—In the cases specified in  
565 section 327 [¶565] of the statute the tax will be specially determined under the provisions of section 328 [¶570], but the tax will not ordinarily be computed under section 328 merely because the corporation's form or manner of organization, or the limitations imposed by section 326 [invested capital, ¶555], result in a greater tax than would otherwise be payable. A corporation which comes within the provisions of subdivision (d) [¶569 of section 327 may make application for assessment under the provisions of section 328, which application shall be attached to its return in the form of a statement setting forth in full: (a) the reasons why the tax should be so determined; (b) the facts upon which such reasons are based; (c) an exact description of each trade or business or important branch of a trade or business carried on by it; (d) a statement of the invested capital and net income for each year since the beginning of the prewar period; and (e) a statement showing the amount of gains, profits, commissions, or other income derived on a cost-plus basis from Government contracts made after April 5, 1917, and before November 12, 1918, and showing the per cent which such income is of the total income of the corporation. See section 1 and article 1510 [for definition of Government contract, law ¶503] and section 326 [¶555] and articles 831-871 [beginning at ¶751, all having to do with invested capital]. (Art. 901, Reg. 45, Rev., Jan. 28, 1921.)

### COMPUTATION OF TAX IN SPECIAL CASES. §328

**832** Art. 911. Computation of tax in special cases.—In the cases specified  
570 in section 327 [¶565] of the statute the tax is to be computed by comparison with representative corporations whose invested capital can be satisfactorily determined under section 326 and which are engaged in a like or similar trade or business and similarly circumstanced. The provisions of section 328 [¶570] do not permit the determination of a general average for any trade or business. In each case which comes under the provisions of section 327 the Commissioner will determine, as nearly as may be, the group or class of corporations with which the corporation should be compared and the amount which bears the same ratio to the net income



of the corporation (in excess of the specific exemption of \$3,000) for the taxable year as the average tax of such representative corporations bears to their average net income (in excess of the specific exemption of \$3,000) for such year. The comparison will take account of similarity with respect to gross income, net income, profit per unit of business transacted and capital employed, the amount and rate of war profits or excess profits, and all other relevant facts and circumstances. (Art. 911, Reg. 45, Rev., Jan. 28, 1921.)

**833 Art. 912. Determination of first installment of tax in special cases.**

**573** —In the case of any corporation, other than a foreign corporation, where absolutely no data are available for the determination of invested capital for the taxable year, the installments of the tax shall in the first instance be determined upon the basis of a war profits and excess profits tax equal to 50% of the net income, except that for 1919 and subsequent taxable years, in the case of any corporation other than a foreign corporation, such installments shall be determined upon the basis of an excess profits tax equal to 20% of the net income in excess of \$3,000.00, but not in excess of \$20,000.00, plus 40% of the net income in excess of \$20,000.00. In any other case under Section 328 of the statute other than the case of a foreign corporation, but including a case where the invested capital for the taxable year cannot be accurately determined, but where a minimum amount of invested capital, as to which there is no question, can be determined, the installments shall in the first instance be determined upon the basis of a war profits and excess profits tax computed by using the minimum invested capital, the tax in any such case not to exceed an amount equal to 50% of the net income, and for 1919 and subsequent taxable years not to exceed 20% of the net income in excess of \$3,000.00, but not in excess of \$20,000.00, plus 40% of the net income in excess of \$20,000.00. [See ¶861.] (Art. 912, Reg. 45, Rev., Jan. 28, 1921, as amended by T. D. 3235, Oct. 6, 1921.)

**834 Art. 913. Determination of first installment of tax in the case of foreign corporation.**

—In the case of a foreign corporation the installments of the tax shall in the first instance be determined upon the basis of a war profits and excess profits tax computed by using its invested capital for the taxable year 1917, such tax for any taxable year not to exceed an amount equal to 50% of the net income, and for 1919 and subsequent taxable years not to exceed 20% of the net income not in excess of \$20,000.00, plus 40% of the net income in excess of \$20,000.00. For the purpose of this Article the invested capital for 1917 shall be adjusted for any subsequent changes in its amount due to cash or property paid in or withdrawn or to surplus or undivided profits of prior years retained in the business and properly attributable to its business within the United States. If the tax for 1917 was determined under Section 210 of the Revenue Act of 1917, the constructive capital which would result in a tax equivalent to the tax determined under that section shall be used. In the case of a foreign corporation which was organized subsequent to the taxable year 1917, or which had no income from sources within the United States during 1917, the installments of the tax shall in the first instance be determined upon the basis of a war profits and excess profits tax equal to 50% of the net income, except that for 1919 and subsequent taxable years such installments shall be determined upon the basis of an excess profits tax equal to 20% of the net income not in excess of \$20,000.00, plus 40% of the net income in excess of \$20,000.00. (Art. 913, Reg. 45, Rev., Jan. 28, 1921, as amended by T. D. 3235, Oct. 6, 1921.)

**835** Art. 914. Payment of tax in special cases.—In any case falling  
 573 under the last two articles the installments shall be paid upon the basis therein provided until the Commissioner notifies the corporation of the amount of tax computed under section 328. The installments shall then be recomputed upon the basis of a war profits and excess profits tax of such amount, and if the amount already paid is less than the amount which would have already become due if the installments had originally been computed upon that basis, the additional amount shall be due and payable ten days after notice and demand from the collector. (Art. 914, Reg. 45, Rev., Jan. 28, 1921.)

**836** Blank. not add to amount.

## REORGANIZATIONS. §330

**837** Art. 931. Scope of Reorganizations.—The first two paragraphs of  
 575 section 330 [§575 and §576] of the statute relate only to the prewar period and not to the invested capital or net income for the taxable year. Under their provisions in the case of a reorganization, consolidation or change of ownership, the corporation is regarded as having been in existence prior to the date of such reorganization, consolidation or change in ownership, and the net income and invested capital of the predecessor trade or business for all or any part of the prewar period prior to the organization of the present corporation are deemed to have been the net income and invested capital of such corporation. (Art. 931, Reg. 45, Rev., Jan. 28, 1921.)

**838** Art. 932. Net Income and Invested Capital of Predecessor Part-  
 576 nership or Individual.—If the predecessor trade or business was carried on by a partnership or individual, the corporation shall make its return of the net income and invested capital of such trade or business as nearly as may be in the same manner as if such trade or business had been carried on by a corporation. It shall submit with its return a statement setting forth (a) the manner in which such trade or business was carried on and (b) the points, if any, in which the provisions of the statute and of the regulations are not fully applicable to the determination of the net income or invested capital of the predecessor trade or business for the prewar period. In no case shall the deduction from gross income for salary or compensation for personal services exceed the salaries or compensation customarily paid at that time by corporations or partnerships of similar size and standing engaged in similar trades or businesses for similar services under like responsibilities. (Art. 932, Reg. 45, Rev., Jan. 28, 1921.)

**839** Art. 933. Election to be Taxed as Corporation.—A business enter-  
 577 prise (a) which is organized as a corporation before July 1, 1919, (b) in which capital is and has been a material income-producing factor, and (c) which was previously owned by a partnership or individual, may elect to be taxed as a corporation on its net income from January 1, 1918, to the date of organization of the corporation. In such event the corporation shall be treated as if in existence since January 1, 1918, for the purposes of the income tax, the war profits and excess profits tax, and the capital stock tax. The adoption of any other date than January 1, 1918, for such purpose is not permissible. But this option is not extended to a business enterprise with a net income for the taxable year 1918 less



than 20 per cent of its invested capital. (Art. 933, Reg. 45, Rev., Jan. 28, 1921.)

**840** Art. 934. Adjustment for Asset Differently Valued in Prewar In-  
**578** vested Capital.—In any case in which as a result of a reorganiza-  
 tion or for any other reason any asset in existence both during the  
 taxable year and any prewar year is included in computing the invested  
 capital for the taxable year, but is not included in computing the invested  
 capital for such prewar year, or is valued on a different basis in computing  
 the invested capital for the two years, the difference resulting therefrom  
 shall not be included in determining the difference 10 per cent of which  
 is added to or deducted from the war profits credit under section 311 (a)  
 (2) of the statute [¶532]. In any such case the corporation shall make the  
 readjustment required by the statute, and shall submit with its return a  
 full statement of the difference in such valuations and of the facts which give  
 rise to such difference. See also section 331 [law ¶579] and article 941 [regula-  
 tions ¶841, for reorganizations after March 3, 1917.] (Art. 934, Reg. 45, Rev.,  
 Jan. 28, 1921.)

### VALUATION OF ASSETS UPON REORGANIZATION. §331

**841** Art. 941. Valuation of Asset upon Change of Ownership.—Where  
**579** a business is reorganized, consolidated or transferred, or property is  
 transferred, after March 3, 1917, and an interest or control of fifty  
 per cent or greater in such business or property remains in the same persons  
 or any of them, then for the purpose of determining invested capital each asset  
 so transferred is valued (a) at an amount representing its actual cash value,  
 subject to the limitations imposed by section 326, but not exceeding its  
 allowable value, for invested capital purposes, in the possession of the  
 previous owner, if a corporation, or, if not a corporation, (b) at its cost to such  
 previous owner, with proper adjustments for losses and improvements.  
 This provision is accordingly concerned with the computation of invested  
 capital for the taxable year, while section 330 of the statute is chiefly con-  
 cerned with the determination of invested capital for the prewar period.  
 See articles 931 [for reorganizations after January 1, 1911, ¶837], 932 [for net  
 income and invested capital of predecessor partnership or individual, ¶838]  
 and 1561-1570 [for basis for determining gain or loss in connection with the  
 sale, exchange or other disposition of property]. (Art. 941, Reg. 45, Rev.,  
 as amended by T. D. 3259, Dec. 7, 1921.)

### FISCAL YEARS ENDING IN 1918 OR 1919. §335

**842** Art. 951. Fiscal year with different rates.—Section 335 [¶580] of  
**580** the statute applies to the war profits and excess profits tax. For  
**583** provisions with respect to the income tax see section 205 of the  
 statute and articles 1621-1625. Subdivision (a), which deals with  
 fiscal years beginning in 1917 and ending in 1918, and subdivision (b) which  
 deals with fiscal years beginning in 1918 and ending in 1919, apply to cor-  
 porations other than personal service corporations. Subdivision (c), which  
 deals with fiscal years beginning in 1917 and ending in 1918, applies to part-  
 nerships and to personal service corporations. See as to partnerships articles  
 321-327 and as to personal service corporations articles 328-335. See also

section 252 of the statute and articles 1034-1036. Partnerships and personal service corporations having fiscal years beginning in 1918 and ending in 1919 are not subject to the war profits and excess profits tax. (Art. 951, Reg. 45, Rev., Jan. 28, 1921.)

**843**     **Art. 952. Fiscal Year of Corporation Ending in 1918.**—The method  
580     provided for computing the tax for a fiscal year beginning in 1917 and ending in 1918 is as follows: (a) the tax attributable to the calendar year 1917 is found by computing the income of the taxpayer and the tax thereon in accordance with Title II of the Revenue Act of 1917 as if the fiscal year was the calendar year 1917, and determining the proportion of such tax which the number of months falling within the calendar year 1917 is of the number of months in the entire period; (b) the tax attributable to the calendar year 1918 is found by computing the income of the taxpayer and the tax thereon in accordance with the present statute as if the fiscal year was the calendar year 1918, and determining the proportion of such tax which the number of months falling within the calendar year is of the number of months in the entire period; and (c) the tax for the fiscal year is found by adding the tax attributable to the calendar year 1917 and the tax attributable to the calendar year 1918. (Art. 952, Reg. 45, Rev., Jan. 28, 1921.)

**844**     **Art. 953. Deductions and Credits in the Case of Fiscal Year Ending**  
581     **in 1918.**—Net losses deductible from net income of the fiscal year under the provisions of section 204 of the statute shall be deductible in computing the tax attributable to the calendar year 1917 as well as in computing the tax attributable to the calendar year 1918. See articles 1601-1603. Amounts previously paid by the taxpayer on account of the excess profits tax for its fiscal year ending in 1918 shall be credited towards the payment of the war profits and excess profits tax imposed for such fiscal year by the present statute. Any excess shall be credited or refunded in accordance with the provisions of section 252 of the statute. For credits for foreign taxes see section 238 of the statute and article 611. (Art. 953, Reg. 45, Rev., Jan. 28, 1921.)

**845**     **Art. 954. Fiscal Year of Corporation Ending in 1919.**—The method  
582     provided for computing the tax for a fiscal year beginning in 1918 and ending in 1919 is as follows: (a) the tax attributable to the calendar year 1918 is found by computing the income of the taxpayer and the tax thereon in accordance with the statute as if the fiscal year was the calendar year 1918, and determining the proportion of such tax which the number of months falling within the calendar year 1918 is of the number of months in the entire period; (b) the tax attributable to the calendar year 1919 is found by computing the income of the taxpayer and the tax thereon in accordance with the statute as if the fiscal year was the calendar year 1919, and determining the proportion of such tax which the number of months falling within the calendar year 1919 is of the number of months in the entire period; and (c) the tax for the fiscal year is found by adding the tax attributable to the calendar year 1918 and the tax attributable to the calendar year 1919. For credits for foreign taxes see section 238 of the statute and article 611. (Art. 954, Reg. 45, Rev., Jan. 28, 1921.)



**846** **Art. 955. Illustration of Computation of Tax for Fiscal Year.**—A corporation makes its return on the basis of a fiscal year ending March 31. It had an average prewar invested capital of \$50,000 and an average prewar net income of \$3,500. For the fiscal year ending March 31, 1918, its invested capital and net income are \$100,000 and \$75,000, respectively, as computed under Title II of the Revenue Act of 1917, and \$125,000 and \$70,000, respectively, as computed under the present statute. Such a difference in these amounts as computed under the two acts may readily occur where, for example, a corporation is allowed under the present statute a deduction for interest, amortization, etc., which it was not allowed under the Revenue Act of 1917, or where, under the present statute, it is allowed a greater amount of invested capital on account of intangible property paid in for stock or shares than allowed under the Revenue Act of 1917. For the fiscal year ending March 31, 1919, its invested capital and net income are \$125,000 and \$60,000, respectively.

**847** (1) A war excess profits tax for the year ending March 31, 1918, as computed under the provisions of Title II of the Revenue Act of 1917, and upon the basis of an invested capital of \$100,000 and a net income of \$75,000 as computed under that Act, is \$32,800. For the details of this computation see illustration (1) under article 16 of Regulations 41. A war profits and excess profits tax for the entire period as computed under subdivision (a) of section 301 of the present statute, and upon the basis of an invested capital of \$125,000 and a net income of \$70,000 as computed under the statute, is \$43,600. Section 335 provides that the tax for this period is the sum of 9/12 of the tax of \$32,800 as computed under the Revenue Act of 1917, or \$24,600, plus 3/12 of the tax of \$43,600 as computed under the present statute, or \$10,900, making a total war excess profits tax for the fiscal year ending March 31, 1918, of \$35,500.

**848** (2) A war profits and excess profits tax for the year ending March 31, 1919, as computed under subdivision (a) of section 301 of the statute is \$35,600. A war profits and excess profits tax for the entire period as computed under subdivision (b) of section 301 is \$16,400. Section 335 provides that the tax for this period is the sum of 9/12 of the tax of \$35,600, as computed under subdivision (a) of section 301, or \$26,700, plus 3/12 of the tax of \$16,400, as computed under subdivision (b) of section 301, or \$4,100, making a total war profits and excess profits tax for the fiscal year ending March 31, 1919, of \$30,800. (Art. 955, Reg. 45, Rev., Jan. 28, 1921.)

## RETURNS.

§336

**849** **Art. 961. Returns.**—Every corporation, domestic or foreign, not  
585 exempt under section 304 [¶525] of the statute and article 751 [¶666] shall make a return for the purpose of the war profits and excess profits tax on form 1120. The return shall be made and the tax shall be paid as provided in the case of a return for and payment of the income tax by corporations. See generally Parts IIA and III of the regulations, and particularly sections 239, 240, 241, 250 and 253 of the statute and the articles thereunder. (Art. 961; Reg. 45, Rev., Jan. 28, 1921.)

**850 Blank.**

**851** **Corporation with no taxable income not required to fill out profits-tax schedules on Form 1120.**—Reference is made to the following telegram of March 19, 1919:

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WAR TAX 371 SERVICE

"Where computation shows that a corporation has no taxable net income must it go to expense of preparing and filling out the schedules relating to excess profits war profits on Form 1120? Is answer any different if the return is a consolidated return? Kindly wire reply."

In reply you are advised that corporations which have no taxable income for the year are required to fill out only Schedules A and B [A, K, and L, for 1920] and the Schedules in support thereof, on their (separate or consolidated) corporate income tax returns (Form 1120), and are not required to furnish the other information called for on these returns. (Letter to Van Vorst, Marshall and Smith, New York, N. Y., signed by J. H. Callan, Assistant to the Commissioner, and dated March 24, 1919.)

**852 Art. 962. Returns in special cases.**—Where a corporation computes its war profits credit upon the basis of the sum of (a) the specific exemption and (b) an amount equal to 10 per cent of the invested capital for the taxable year, the items on form 1120 which relate solely to the net income or to the invested capital for the prewar period need not be filled in. Where a corporation enters on its return a war profits and excess profits tax equal to the amount of the maximum tax determined under section 302 [¶523] of the statute, the items on form 1120 which relate solely to the net income for the prewar period and the items which relate to the invested capital for the prewar period and for the taxable year need not be filled in. Likewise in the case of a foreign corporation the same items may be disregarded, except that balance sheets as of the beginning and the end of the taxable year for the entire business of the corporation both within and without the United States shall be submitted. See article 871 [for foreign corporations, ¶830]. The Commissioner may at any time specifically call for all or any part of the information which under this article is not required to be entered on the return. In any case, however, where a claim is made under sections 327 [¶565] and 328 [¶570] of the statute, other than in the case of a foreign corporation, the corporation should fill out all items of the return so far as possible and submit a statement explaining why it is impracticable to fill out the entire return. (Art. 962, Reg. 45, Rev., Jan. 28, 1921.)

#### SALE OF MINERAL DEPOSITS.

§337

**853 Art. 971. Tax on Sale of Mineral Deposits.**—In the case of a sale  
**586** of mines, oil or gas wells, or any interest therein, as described in article 13 [thirteen], the portion of the war profits and excess profits tax attributable to such a sale shall not exceed 20 per cent of the selling price. To determine the application of this provision to a particular case the corporation should compute the war profits and excess profits tax in the ordinary way upon its net income, including its net income from any such sale. The proportion of the total tax indicated by the ratio which the taxpayer's net income from the sale of the property, computed as prescribed in article 715, bears to its total net income is the portion of the tax attributable to such sale, and if it exceeds 20 per cent of the selling price of the property such portion of the tax shall be reduced to that amount. See articles 219, 220, 220(a), and 221. (Art. 971, Reg. 45, Rev., Jan. 28, 1921.)

**854 to 857 Blank.**



**858** **Art. 972. Illustration of Computation of Tax Where Sale of Mineral Deposits.**—In the case of the corporation used as an illustration in article 716, let it be assumed that its gross income for 1918 included \$15,000 derived from a bona fide sale of an oil well, the principal value of which had been demonstrated by exploration and discovery work done by the corporation, and that the Commissioner finds under article 715 that only \$800 of the deductions allowed are properly applicable to the gross income derived from the sale. The portion of the net income attributable to the sale would be \$14,200, which is 35.5 per cent of the entire net income of \$40,000, and the portion of the tax for that year attributable to the sale will be 35.5 per cent of the entire tax of \$17,600, or \$6,248. But this portion of the tax can not exceed 20 per cent of the selling price (\$15,000) and is accordingly reduced to \$3,000. The total tax will be \$11,352 (the portion of the tax not affected) plus \$3,000, or \$14,352 (instead of \$17,600). (Art. 972, Reg. 45, Rev., Jan. 28, 1921.)

§1309

**859** **Promulgation of Regulations No. 45, Revised.**—In pursuance of the statute [see ¶860] the foregoing regulations are hereby made and promulgated and all rulings inconsistent herewith are hereby revoked. Art. 1800, Reg. 45, Rev., Jan. 28, 1921.)

**860** **Sec. 1309 [of the Revenue Act of 1918].** That the Commissioner, with the approval of the Secretary, is hereby authorized to make all needful rules and regulations for the enforcement of the provisions of this Act.

**861** **Estimate of amount of excess payment on account of any expected**  
**833** **but undetermined relief under Section 328 for prior year not to be**  
**credited against first installment of tax for succeeding year which**  
**tax is to be computed in first instance without regard to former**  
**claim.**—Reference is made to your letter of March 8, 1921, relative to corporation returns to be filed for 1920 under the provisions of Sections 327 and 328 of the Revenue Act of 1918.

**862** You state that it is your understanding that in filing returns for 1920 under the above-mentioned sections, claim for credit may be applied against the amount of the first installment of tax due thereon to the extent that it is estimated the amount of tax paid was in excess of the amount due as computed under the provisions of Section 328. You inquire as to a justifiable percentage of tax on income for 1919 to be used as the basis for a claim for credit against the first installment of the tax for 1920.

**863** In reply your attention is invited to Section 328(a) which provides in part that "In the cases specified in section 327 the tax shall be the amount which bears the same ratio to the net income of the taxpayer (in excess of the specific exemption of \$3,000) for the taxable year, as the average tax of representative corporations engaged in a like or similar trade or business bears to their average net income (in excess of the specific exemption of \$3,000) for such year." The special relief afforded by Sections 327 and 328 is based upon the merits of the individual case, and the provisions of Section 328 to not permit the determination of a general average for any trade or business.

**864** Claim for credit may not under any circumstances be applied against taxes due until the Bureau has definitely determined that the amount of the claim is actually in excess of the amount of taxes due on the previous

return. Until complete audit comparatives are available for use in computing under Section 328 the taxes due on 1919 returns, the exact amount of tax due thereon can not be determined, and, consequently, claims for credit in the amounts believed to be in excess of tax due for the previous year may not be applied against the amount of the first installment of the 1920 taxes. (Letter to The Corporation Trust Company, signed by Commissioner Wm. M. Williams, and dated March 23, 1921.)

**865** Use of appreciated or inflated values in determining invested capital  
555 shown in income and excess profits tax returns for 1917 and subse-  
751 quent years.—An examination of income and excess profits tax  
returns for 1917 and subsequent years has disclosed that many tax-  
payers have used appreciated and inflated values in determining invested  
capital shown in such returns contrary to Section 207 of the Revenue  
Act of 1917 and Section 326 of the Revenue Act of 1918.

**866** This office has held consistently that the use of appreciated or in-  
flated values in determining invested capital is not permissible and  
this ruling has been sustained by the United States Supreme Court in the  
case of the La Belle Iron Works v. The United States (41 Sup. Ct. 528;  
T. D. 3051 [¶889 herein]).

**867** All taxpayers who, in the preparation of their income and excess  
profits tax returns for 1917 and subsequent years, have used appre-  
ciated or inflated values in determining the amount of their invested capital  
are required to file with the Collector of Internal Revenue within 90 days  
from date of this decision amended returns\* for each of such years, in which  
the invested capital shall be computed strictly in accordance with the law  
and regulations and without the use of appreciated or inflated values. It  
is not required that such amended returns shall include the figures shown  
in the original returns which are unaffected by this decision. Only such  
figures as are necessary to show the correct values used in the computation  
of invested capital and such totals as are necessary to a redetermination of  
the tax need be shown. Payment of the additional tax shown to be due on  
such amended returns must also be made at the time the returns are filed.

**868** Failure to file amended returns within the time specified will subject  
taxpayers to the penalties provided for in Section 3176 [¶8071], United  
States Revised Statutes, as amended. (T. D. 3220, signed by Commissioner  
D. H. Blair, and dated August 26, 1921.)

\*Amended returns required though no further tax due. See O. D. 1131 (Ruling No. 29, at Sec. 326. Art. 831.-20, in Supplementary Bulletin Rulings, post.)

**869** Interpretation of T. D. 3220 requiring amended returns in cases where  
appreciated or inflated values have been used in determining amount  
of invested capital under the Revenue Act of 1917 and 1918.—  
1. Attention is directed to T. D. 3220 [¶865] dated August 26, 1921, in which  
amended income and excess profits tax returns are required for 1917 and sub-  
sequent years in cases where appreciated or inflated values have been used  
in determining the amount of invested capital. This decision was based on  
the decision of the United States Supreme Court in the case of the La Belle  
Iron Works v. The United States (41 Sup. Ct. 528) [¶889].



**870** 2. Numerous inquiries have reached this office in regard to the meaning of that Treasury Decision and it is possible that the Collectors of Internal Revenue will be asked whether certain cases fall within its provisions. It should be clearly understood that the purpose of that Treasury Decision was to have amended returns filed and tax paid to the Government in cases where returns were filed contrary to the regulations, Section 207 of the Revenue Act of 1917 and Section 326 of the Revenue Act of 1918.

**871** 3. It was the intention that the tax due the Government as the result of the use of appreciated values should be paid into the Treasury immediately rather than waiting until the returns are finally reached in the regular course of audit. The fact that a field investigation has been made or that the return is in the process of audit in the Bureau is not sufficient to waive the filing of amended returns. Where the taxpayer has received a letter from the Bureau notifying him of an additional assessment as the result of the elimination from his original return of such appreciated or inflated values, it will not be necessary to file amended returns referred to in that decision. In each case where a taxpayer in your district is in doubt as to whether amended returns should be filed, a complete statement of facts should be submitted to this office for a ruling.

**872** 4. It is possible that certain taxpayers, on account of unusual conditions, can not comply with the provisions of T. D. 3220 and file their returns by November 24, the due date of the amended returns under that decision. If, prior to November 24, 1921, conditions seem to warrant, the Bureau will give consideration to the question of a supplemental Treasury Decision extending the due date beyond November 24, 1921, for the filing of amended returns required by that decision. [See ¶875.]

**873** 5. Collectors of Internal Revenue are not authorized to grant any extension of time in this respect and taxpayers should be so advised. You will, therefore, refer to this office all cases which require special consideration.

**874** You are requested to acknowledge receipt of this mimeograph. (IT. Mim. Coll. No. 2848, signed by Commissioner D. H. Blair, and dated October 19, 1921.)

**875** Extension of time for filing amended returns required by Treasury Decision 3220 in cases in which appreciated or inflated values have been used in determining invested capital.—Under the provisions of Treasury Decision 3220 [¶865], approved August 26, 1921, all taxpayers who, in the preparation of their income and profits tax returns for 1917 and subsequent years, have used appreciated or inflated values in determining the amount of their invested capital, are required to file amended returns within ninety days from the date of that decision and make payment of the additional tax shown to be due.

**876** In view of the fact that many taxpayers are unable to complete their returns by November 24, 1921, the last date under which amended returns may be filed, as provided by Treasury Decision 3220, an extension of time up to and including January 15, 1922, is hereby granted within which to file such amended returns and make payment of the additional tax due. (T. D. 3243, signed by Commissioner D. H. Blair, and dated November 14, 1921.)

**Adjustments in surplus and undivided profits account because of alleged failure to charge off depreciation.**

MEMORANDUM NO. 106.  
COMMITTEE ON APPEALS AND REVIEW.

February 26, 1921.

Mr. Commissioner:

(For Mr. Newton)

**877** The Committee is in receipt of a request for advice relative to the  
762 practice of field agents in reducing earned surplus by deductions for depreciation where none had been claimed in the past, or where a lower rate has been claimed than is ordinarily allowable with respect to the depreciable assets in question.

**878** It is the judgment of the Committee that there is no warrant for reducing earned surplus because of alleged failure to charge off sufficient depreciation in the past, unless the depreciable assets of the corporation are valued on its books at the beginning of the taxable year at an amount in excess of their actual value at that time. This is particularly true where the corporation in prior years earned positive income from which larger deductions for depreciation might have been taken, if in the opinion of the officers and directors of the corporation such larger charges had been justified. Nothing herein is to be construed as precluding the Income Tax Unit from adjusting depreciation, either by way of increase or decrease, where there is at hand affirmative evidence that as at the beginning of a taxable year the amount of depreciation written off in prior years was insufficient or excessive. The correct attitude of the Bureau and the proper conduct of its field agents, in particular, are plainly set forth in that part of Art. 839 of Reg. 45, which reads:

“Adjustments in respect of depreciation or depletion in prior years will be made or permitted only upon the basis of affirmative evidence that as at the beginning of the taxable year the amount of depreciation or depletion written off in prior years was insufficient or excessive, as the case may be.”

(Signed) N. T. Johnson,  
Chairman,

Committee on Appeals and Review.

Noted:

(Signed) Carl A. Mapes, Solicitor of Internal Revenue.

Accepted for the guidance of the Income Tax Unit:

(Signed) M. F. West, Acting Commissioner of Internal Revenue.

**879** Adjustments in surplus and undivided profits account because of  
762 alleged failure to charge off depreciation.—Specific inquiry has been made as to the meaning of the words “actual value” as used in Committee on Appeals and Review memorandum No. 106 [¶877]. For the purposes of taxation depreciation is based upon cost. Accordingly, the words “actual value” mean “sound value”, which is “original cost” (or value as of March 1, 1913, if applicable), including additions and betterments charged to capital account, less depreciation sustained.

**880** Article 161, Regulations 45 (1920 edition) defines the proper allowance for depreciation as “that amount which should be set aside for the taxable year in accordance with a consistent plan by which the aggregate of such amounts for the useful life of the property in the business



will suffice, with the salvage value, at the end of such useful life to provide in place of the property its cost, or its value as of March 1, 1913, if acquired by the taxpayer before that date."

**881** It follows from this definition that any action on the part of a particular taxpayer which extends the useful life of a depreciable asset beyond the normal or usual term, and any circumstance which serves to increase the salvage value of a depreciable asset, operates to justify a reduction in the normal rate of depreciation. The depreciation of an asset is arrested where it is maintained at a high standard of efficiency either by the exercise of unusual care in its use or by unusual maintenance expenditures.

**882** Invested capital, as defined in the Excess Profits Tax Law, is a statutory concept and is composed of two elements: (a) original contribution, and (b) earnings of the corporation available for distribution but not distributed and not dissipated by subsequent operating losses. The exhaustion of this capital through use, wear and tear has, for the purpose of computing invested capital, the same effect as an operating loss and unless this loss is properly taken care of out of earnings in one way or another, earned surplus must be adjusted in accordance with the provisions of the regulations. There are two ways of taking care of this loss out of income. One is by charging ordinary repairs directly to expense and setting up a depreciation reserve against which are properly chargeable all renewals and replacements; the other is where renewals and replacements, as well as repairs, have been charged directly against gross income. Either way has the effect of reducing the amount added during the year to earned surplus. Consequently, the mere fact that no depreciation, or a minimum depreciation, has been charged as such, is not sufficient reason for reducing the earned surplus, where renewals and replacements sufficient to care for the decrease in value of capital assets have been charged directly to expense, or where for any of the other reasons hereinbefore suggested less than the normal rate of depreciation is properly chargeable. When a taxpayer makes this claim there are two methods of verifying it. One is by determining the plant efficiency and the other is by determining the value of the capital assets remaining. From an administrative standpoint the latter is probably more practical even though it may be said that the former is more accurate.

**883** Many cases have been brought to the attention of the Committee where corporations have been in existence for a long period of years, some of which corporations have been in existence several times the ordinary estimated life of the depreciable assets, and yet those assets are today in first-class condition and worth the figure at which they are carried on the books, although no depreciation has been charged as such and no additions to capital account have been made. In such cases it is obvious that depreciation has been adequately cared for by charges to expense, although it frequently happens that it is impossible at this late date to segregate and specify such charges and there is no warrant in the law or the regulations for requiring the depreciable assets in such cases to be written down below the figure at which they are carried on the books, since to do so is to reduce earned surplus twice, once through the original charge to expense (whether proper or improper), and again through an arbitrary depreciation charge required by the Bureau to be set up against earned surplus for the purpose of computing invested capital.

**884** The controlling rule in this matter is found in that part of Article 839 of Regulations 45, which reads: "Adjustments in respect of depreciation or depletion in prior years will be made or permitted only upon the

basis of affirmative evidence that as at the beginning of the taxable year the amount of depreciation or depletion written off in prior years was insufficient or excessive, as the case may be." *Mere failure in prior years to have written off on the books the maximum or ordinary rate of depreciation, is not in itself "affirmative evidence."* There is no warrant for reducing earned surplus because of alleged failure to charge off sufficient depreciation in the past, unless the depreciable assets of the corporation are valued on its books at the beginning of the taxable year at an amount in excess of their sound value at that time. (Statement by the Committee on Appeals and Review, signed by N. T. Johnson, Chairman, and dated July 6, 1921 (released for publication July 15, 1921). Noted by Carl A. Mapes, Solicitor of Internal Revenue.)

**835** Adjustments in surplus and undivided profits account because of  
**762** alleged failure to charge off depreciation.—Reference is made to Committee on Appeals and Review Memorandum 106 [¶877] and explanatory memorandum of the Committee dated July 6, 1921 [879].

**836** The attention of the Commissioner's office has been called to the fact that Article 839 [¶762] of Regulations 45 as interpreted by Committee Memorandum 106 and the memorandum of July sixth, has not been properly followed.

**887** When the Regulation (Article 839 of Regulations 45) was being drafted it was the intention of the draftsmen that a corporate surplus account was not to be disturbed lightly and that no change should be made in it either by the Government or by the taxpayer except upon adequate evidence that the surplus account was incorrect. It was the view of the draftsmen that unless the taxpayer could show a state of error, the Government should deny a claim for an increase in the surplus shown by the taxpayer's books; conversely, before a deduction could be made from the taxpayer's surplus account, the Government must show that such an adjustment is necessary to correct the account. The view was also held that such proof must be in the form of affirmative evidence—that it could not rest upon mere assertion of the working out of the theoretical formula.

**888** It is my opinion that no doubt ever should have existed as to the correct interpretation of Article 839. A taxpayer's corporate surplus should not be reduced by the arbitrary adjustment of depreciation and depletion for past years. Surplus accounts should, however, always be carefully scrutinized and checked up for the purpose of preventing the inclusion therein of appreciated values of property. In case of doubt in such case the burden should be cast upon the taxpayer to prove that no appreciative values were included in the surplus. A presumption should always exist that a taxpayer's books of account reflect actual facts. The burden of proof is upon any one who attempts to impugn the correctness of the books of account—upon the Government if it seeks to reduce its surplus account by charging off depreciation and depletion which have not been claimed by the taxpayer and upon the taxpayer where he claims that too much depreciation and depletion have been charged off in prior years. (Memorandum, signed by Commissioner D. H. Blain, and dated November 1, 1921.)



(Decision.)  
Revenue Act of 1917.

The excess of actual value of property over its cost in cash, subsequently capitalized, a stock dividend being declared, all prior to incidence of tax, is not to be included as invested capital either as paid-in surplus, or, because of the stock dividend involving the surrender and cancellation of the original stock, on account of "the actual cash value of tangible property paid in other than cash, for stock."—The Act is constitutional.

SUPREME COURT OF THE UNITED STATES.

La Belle Iron Works, Appellant, }  
vs. The United States. } Appeal from the Court of Claims.  
The United States. }

(256 U. S. 377.)

Mr. Justice PITNEY delivered the opinion of the Court.

**889** The Court of Claims dismissed appellant's petition which claimed  
**555** a refund of \$1,081,184.61, alleged to have been erroneously assessed  
**751** and exacted as an "excess profits tax" under Title II of the Revenue Act of 1917 (Act of October 3, 1917, Ch. 63, 40 Stat. 300, 302, *et seq.*). The case involves the construction and application of those provisions by which the deduction from income, for the purposes of the tax, is measured by the "invested capital" of the taxpayer; and a question is raised as to the constitutionality of the Act as construed and applied.

**890** Title I of the Act imposed "War Income Taxes" upon individuals and corporations in addition to those imposed by Act of September 8, 1916 (Ch. 463, 39 Stat. 756). Title II provided for the levying of "War Excess Profits Taxes" upon corporations, partnerships, and individuals. As applied to domestic corporations, the scheme of this Title was that, after providing for a deduction from income (sec. 203, p. 304) equal to the same percentage of the invested capital for the taxable year which the average amount of the annual net income of the trade or business during the prewar period (the years 1911, 1912, and 1913) was of the invested capital for that period, but not less than 7 nor more than 9 per cent., plus \$3,000, it imposed (sec. 201, p. 303), in addition to other taxes, a graduated tax upon the net income beyond the deduction, commencing with 20 per centum of such net income above the deduction but not above 15 per centum of the invested capital for the taxable year, and running as high as 60 per centum of the net income in excess of 33 per centum of such capital. It applied to "all trades or businesses," with exceptions not now material (p. 303).

**891** What should be deemed "invested capital" was defined by sec. 207 (p. 306), which, so far as pertinent, is set forth in the margin.\*

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\*SEC. 207. That as used in this title, the term "invested capital" for any year means the average invested capital for the year, as defined and limited in this title, averaged monthly.

As used in this title "invested capital" does not include stocks, bonds (other than obligations of the United States), or other assets, the income from which is not subject to the tax imposed by this title, nor money or other property borrowed, and means, subject to the above limitations:

(a) In the case of a corporation or partnership: (1) Actual cash paid in, (2) the actual cash value of tangible property paid in other than cash, for stock or shares in such corpora-

**892** The case was decided upon a demurrer to the petition, in which the facts were stated as follows: Appellant is a domestic corporation and, prior to the year 1904, acquired ore lands for which it paid the sum of \$190,000. Between that time and the year 1912 extensive explorations and developments were carried on (the cost of which is not stated), and it was proved that the lands contained large bodies of ore and had an actual cash value not less than \$10,105,400; and at all times during the years 1912 to 1917, inclusive, their actual cash value was not less than the sum last mentioned. In the year 1912 the company increased the valuation of said lands upon its books by adding thereto the sum of \$10,000,000, which it carried to surplus, and thereupon, in the same year, declared a stock dividend in the sum of \$9,915,400, representing the increase in value of the ore lands. Theretofore appellant's capital stock had consisted of shares issued, all of one class, having a par value of \$9,915,400. The declaration of the stock dividend was carried out by the surrender to the company of all the outstanding stock, and its cancellation, and the exchange of one share of new common and one share of new preferred stock for each share of the original stock.

**893** In returning its annual net income for the year 1917 the company stated its invested capital to be \$26,322,904.14, in which was included the sum of \$10,105,400 as representing the value of its ore lands. The Commissioner of Internal Revenue caused a reassessment to be made, based upon a reduction of the invested capital to \$16,407,507.14; the difference (\$9,915,400) being the increase in the value of the ore lands already mentioned. The result was an additional tax of \$1,081,184.61, which, having been paid, was made the subject of a claim for refund; and this having been considered and rejected by the Commissioner, there followed a suit in the Court of Claims, with the result already mentioned.

**894** Appellant's contentions, in brief, are, first, that the increased value of the ore lands, placed upon the company's books in 1912, ought to be included in invested capital under sec. 207 (a) (3), as "paid in or earned surplus and undivided profits." Second, that within the meaning of clause (2), which provides that invested capital shall include "the actual cash value

tion or partnership, at the time of such payment (but in case such tangible property was paid in prior to January first, nineteen hundred and fourteen, the actual cash value of such property as of January first, nineteen hundred and fourteen, but in no case to exceed the par value of the original stock or shares specifically issued therefor), and (3) paid in or earned surplus and undivided profits used or employed in the business, exclusive of undivided profits earned during the taxable year: *Provided*, That (a) the actual cash value of patents and copyrights paid in for stock or shares in such corporation or partnership, at the time of such payment, shall be included as invested capital, but not to exceed the par value of such stock or shares at the time of such payment, and (b) the good will, trade-marks, trade brands, the franchise of a corporation or partnership, or other intangible property, shall be included as invested capital if the corporation or partnership made payment bona fide therefor specifically as such in cash or tangible property, the value of such good will, trade-mark, trade brand, franchise, or intangible property, not to exceed the actual cash or actual cash value of the tangible property paid therefor at the time of such payment; but good will, trade-marks, trade brands, franchise of a corporation or partnership, or other intangible property, bona fide purchased, prior to March third, nineteen hundred and seventeen, for and with interests or shares in a partnership or for and with shares in the capital stock of a corporation (issued prior to March third, nineteen hundred and seventeen), in an amount not to exceed, on March third, nineteen hundred and seventeen, twenty per centum of the total interests or shares in the partnership or of the total shares of the capital stock of the corporation, shall be included in invested capital at a value not to exceed the actual cash value at the time of such purchase, and in case of issue of stock therefor not to exceed the par value of such stock;



of tangible property paid in other than cash, for stock or shares in such corporation," the stock of the company issued in 1912, consisting of \$9,915,400 of preferred stock and an equal amount of common, was fully paid for: either (a) by the tangible assets, including the ore properties at their increased value, or (b) by the surrender of all the certificates representing the old common stock, which, it is said, had an actual cash value equal to double its par. And, third, that the construction put upon the Act by the Treasury Department, based as it is said not upon value but upon the single feature of cost, disregarding the time of acquisition, would render the Act unconstitutional as a deprivation of property without due process under the Fifth Amendment, because so arbitrary as to amount in effect to confiscation; and hence that this construction must be avoided.

**895** Reading the entire language of Section 207 in the light of the circumstances that surrounded the passage of the Act, we think its meaning as to "invested capital" is entirely clear. The great war in Europe had been in progress since the year 1914, and the manufacture and export of war supplies and other material for the belligerent powers had stimulated many lines of trade and business in this country, resulting in large profits as compared with the period before the war, and as compared with ordinary returns upon the capital embarked. The United States had become directly involved in the conflict in the Spring of 1917, necessitating heavy increases in taxation; at the same time manufactures and trade of every description were rendered even more active, and in certain lines more profitable, than before, so that the unusual gains derived therefrom formed a natural subject for special taxation.

**896** On the eve of our entry, and in order to provide a "Special Preparedness Fund" for army, navy, and fortification purposes, an Act (March 3, 1917; Ch. 159, 39 Stat. 1000) was passed, which, in Title II, provided for an excess profits tax on corporations and partnerships equal to 8 per centum of the amount by which their net income exceeded \$5,000 plus 8 per centum of the "actual capital invested"; and, in sec. 202 (p. 1001), defined this term to mean "(1) actual cash paid in, (2) the actual cash value, at the time of payment, of assets other than cash paid in, and (3) paid in or earned surplus and undivided profits used or employed in the business," but not to include money or other property borrowed.

**897** The Revenue Act of October 3, 1917, passed after we had become engaged in the war, took the place of the Act of March 3, and embodied a "War Excess Profits Tax," with higher percentages imposed upon the income in excess of deductions and a more particular definition of terms. A scrutiny of the particular provisions of Section 207 shows that it was the dominant purpose of Congress to place the peculiar burden of this tax upon the income of trades and businesses exceeding what was deemed a normally reasonable return upon the capital actually embarked. But if such capital were to be computed according to appreciated market values based upon the estimates of interested parties (on whose returns perforce the Government must in great part rely), exaggerations would be at a premium, corrections difficult, and the tax easily evaded. Section 207 shows that Congress was fully alive to this and designedly adopted a term—"invested capital"—and a definition of it, that would measurably guard against inflated valuations. The word "invested" in itself imports a restrictive qualification. When speaking of the capital of a business corporation or partnership, such as the Act deals with, "to invest" imports a laying out of money, or money's worth, either an individual in acquiring an interest in the concern with a view

to obtaining income or profit from the conduct of its business, or by the concern itself in acquiring something of permanent use in the business; in either case involving a conversion of wealth from one form into another suitable for employment in the making of the hoped-for gains. See Webster's New Internat. Dict., "Invest", 8; Century Dict., "invest", 7; Standard Dict., "invest", 1.

**898** In order to adhere to this restricted meaning and avoid exaggerated valuations, the draftsman of the Act resorted to the test of including nothing but money, or money's worth, actually contributed or converted in exchange for shares of the capital stock, or actually acquired through the business activities of the corporation or partnership (involving again a conversion) and coming in *ab extra*, by way of increase over the original capital stock. How consistently this was carried out becomes evident as the section is examined in detail. Cash paid in, and tangible property paid in other than cash, are confined to such as were contributed for stock or shares in the corporation or partnership; and the property is to be taken at its actual cash value "at the time of such payment"—distinctly negating any allowance for appreciation in value. There is but a single exception: tangible property paid in prior to January 1, 1914, may be taken at its actual cash value on that date, but in no case exceeding the par value of the original stock or shares specifically issued for it; a restriction in itself requiring the valuation to be taken as of a date prior to the war period, and in no case to exceed the stock valuation placed upon it at the time it was contributed. The provision of clause (3) that includes "paid in or earned surplus and undivided profits used or employed in the business" recognizes that in some cases contributions are received from stockholders in money or its equivalent for the specific purpose of creating an actual excess capital over and above the par value of the stock; and, in view of the context, surplus "earned" as well as that "paid in" excludes the idea of capitalizing (for the purposes of this tax) a mere appreciation of values over cost.

**899** The same controlling thought is carried into the proviso, which relates to the valuation of patents, copyrights, trade-marks, good will, franchises, and similar intangible property. Every line shows evidence of a legislative purpose to confine the account to such items as were paid in for stock or shares, and to their values "at the time of such payment"; but, with regard to those *bona fide* purchased prior to March 3, 1917, there is a special provision, limiting the effect of any adjustments that might have been made in view of the provisions of the Act of that date.

**900** It is clear that clauses (1) and (2) refer to actual contributions of cash or of tangible property at its cash value contributed in exchange for stock or shares specifically issued for it; and that neither these clauses, nor clause (3) which relates to surplus, can be construed as including within the definition of invested capital any marking up of the valuation of assets upon the books to correspond with increase in market value, or any paper transaction by which new shares are issued in exchange for old ones in the same corporation, but which is not in substance and effect a new acquisition of capital property by the company.

**901** It is clear enough that Congress adopted the basis of "invested capital" measured according to actual contributions made for stock or shares and actual accessions in the way of surplus, valuing them according to actual and *bona fide* transactions and by valuations obtaining at the time of acquisition, not only in order to confine the capital, the income from which was to be in part exempted from the burden of this special tax, to something



approximately representative of the risks accepted by the investors in embarking their means in the enterprise, but also in order to adopt tests that would enable returns to be more easily checked by examination of records, and make them less liable to inflation than if a more liberal meaning of "capital and surplus" had been adopted; thus avoiding the necessity of employing a special corps of valuation experts to grapple with the many difficult problems that would have ensued had general market values been adopted as the criteria.

**902** In view of the special language employed in Section 207, obviously for the purpose of avoiding appreciated valuations of assets over and above cost, the argument that such value is as real as cost value, and that in the terminology of corporation and partnership accounting "capital and surplus" mean merely the excess of all assets at actual values over outstanding liabilities, and "surplus" means the intrinsic value of all assets over and above outstanding liabilities plus par of the stock, is beside the mark. Nor has the distinction between capital and income, discussed in *Doyle v. Mitchell Bros. Co.*, 247 U. S. 179, 187; *Hays v. Gauley Mtn. Coal Co.*, 247 U. S. 189, 193; and *Southern Pacific Co. v. Lowe*, 247 U. S. 330, 334-335, any proper bearing upon the questions here presented.

**903** Upon the strength of an administrative interpretation contained in a Treasury Regulation pertaining to the Revenue Act of 1917, under which "stocks" were to be regarded as tangible property when paid in for stock or shares of a corporation, it is insisted that appellant's stock dividend distribution of 1912 ought to be treated as paid for in tangible property, the old stock surrendered being regarded as tangible for the purpose. But that distribution, in substance and effect, was an internal transaction, in which the company received nothing from the stockholders any more than they received anything from it (see *Eisner v. Macomber*, 252 U. S. 189, 210-211); and the old shares cannot be regarded as having been "paid in for" the new ones within the meaning of Section 207 (a) (2), even were they "stocks" within the meaning of that Regulation, which is doubtful.

**904** It is said that the admitted increase in the value of appellant's ore lands is properly to be characterized as earned surplus, because it was the result of extensive exploration and development work. We assume that a proper sum, not exceeding the cost of the work, might have been added to earned surplus on that account; but none such was stated in appellant's petition, nor, so far as appears, in its return of income. In the absence of such a showing it was not improper to attribute the entire \$9,915,400, added to the book value of the ore property in the year 1912, to a mere appreciation in the value of the property; in short, to what is commonly known as the "unearned increment," not properly "earned surplus" within the meaning of the statute.

**905** The foregoing considerations dispose of the contention that either the increased value of appellant's ore lands, or the surrender of the old stock in exchange for the new issues based upon that value, can be regarded as "tangible property paid in other than cash, for stock or shares in such corporation" within the meaning of sec. 207 (a) (2); and of the further contention that such increased value can properly be regarded as "paid in or earned surplus and undivided profits" under sec. 207 (a) (3).

**906** It is urged that this construction, defining invested capital according to the original cost of the property instead of its present value, has the effect of rendering the Act "glaringly unequal" and of doubtful constitutionality; the insistence being that, so construed, it operates to

produce baseless and arbitrary discriminations, to the extent of rendering the tax invalid under the due process of law clause of the Fifth Amendment. Reference is made to cases decided under the equal protection clause of the Fourteenth Amendment (*Southern Ry. Co. v. Greene*, 216 U. S. 400, 418; *Gast Realty Co. v. Schneider Granite Co.*, 240 U. S. 55); but clearly they are not in point. The Fifth Amendment has no equal protection clause; and the only rule of uniformity prescribed with respect to duties, imposts, and excises laid by Congress is the territorial uniformity required by Art. I, sec. 8. *Pollock v. Farmers' Loan & Trust Co.*, 157 U. S. 429, 557; *Knowlton v. Moore*, 178 U. S. 41, 98, 106; *Flint v. Stone Tracy Co.*, 220 U. S. 107, 150; *Billings v. United States*, 232 U. S. 261, 282; *Brushaber v. Union Pacific R. R.*, 240 U. S. 1, 24. That the statute under consideration operates with territorial uniformity is obvious and not questioned.

**907** Appellant cites *Looney v. Crane Co.*, 245 U. S. 178, 188, and *International Paper Co. v. Massachusetts*, 246 U. S. 135, 145, but these cases also are inapplicable, being based upon the due process clause of the Fourteenth Amendment, with which state taxing laws were held in conflict because they had the effect of imposing taxes on the property of foreign corporations located and used beyond the jurisdiction of the taxing State. There is no such infirmity here.

**908** Nor can we regard the Act—in basing “invested capital” upon actual costs to the exclusion of higher estimated values—as productive of arbitrary discriminations raising a doubt about its constitutionality under the due process clause of the Fifth Amendment. The difficulty of adjusting any system of taxation so as to render it precisely equal in its bearing is proverbial, and such nicety is not even required of the States under the equal protection clause, much less of Congress under the more general requirement of due process of law in taxation. Of course it will be understood that Congress has very ample authority to adjust its income taxes according to its discretion, within the bounds of geographical uniformity. Courts have no authority to pass upon the propriety of its measures; and we deal with the present criticism only for the purpose of refuting the contention, strongly urged, that the tax is so wholly arbitrary as to amount to confiscation.

**909** The Act treats all corporations and partnerships alike, so far as they are similarly circumstanced. As to one and all, Congress adjusted this tax, generally speaking, on the basis of excluding from its operation income to the extent of a specified percentage (7 to 9 per cent) of the capital employed, but upon condition that such capital be valued according to what actually was embarked at the outset or added thereafter, disregarding any appreciation in values. If in its application the tax in particular instances may seem to bear up on one corporation more than upon another, this is due to differences in their circumstances, not to any uncertainty or want of generality in the tests applied.

**910** Minor distinctions—such as those turning upon the particular dates of January 1, 1914, and March 3, 1917—are easily explained, as we have seen. The principal line of demarcation—that based upon actual costs, excluding estimated appreciation—finds reasonable support upon grounds of both theory and practice, in addition to the important consideration of convenience in administration, already adverted to. There is a logical incongruity in entering upon the books of a corporation as the capital value of property acquired for permanent employment in its business and still retained for that purpose, a sum corresponding not to its cost but to what probably might be realized by sale in the market. It is not merely



that the market value has not been realized or tested by sale made, but that sale cannot be made without abandoning the very purpose for which the property is held, involving a withdrawal from business so far as that particular property is concerned. Whether in a given case property should be carried in the capital account at market value rather than at cost may be a matter of judgment, depending upon special circumstances and the local law. But certainly Congress, in seeking a general rule, reasonably might adopt the cost basis, resting upon experience rather than anticipation.

**911** In organizing corporations, it is not unusual to issue different classes of securities, with various priorities as between themselves, to represent different kinds of contribution to capital. In exchange for cash, bonds may be issued; for fixed properties, like plant and equipment, preferred stock may be given; while more speculative values, like good-will or patent rights, may be represented by common stock. In the present case, for instance, when appellant took the estimated increase in value of its ore lands as a basis for increased capitalization, it issued preferred stock to the amount of the former total, carrying those lands at cost, and issued a like amount of common stock to represent the appreciation in their market value. It does not appear that in form the new issues were thus allocated; but at least there was a recognition of a higher claim in favor of one part of the book capital than of the other. Upon like grounds, it was not unreasonable for Congress, in adjusting the "excess profits tax," to accord preferential treatment to capital representing actual investments, as compared with capital representing higher valuations based upon estimates, however confident and reliable, of what probably could be realized were the property sold instead of retained.

**912** From every point of view, the tax in question must be sustained.

We intimate no opinion upon the effect of the Act with respect to deductions from cost values of capital assets because of depreciation or the like; no question of that kind being here involved.

*Judgment affirmed.*

Mr. Justice McREYNOLDS concurs in the result.

[T. D. 3181.]

*(Decision.)**Revenue Act of 1917—War Excess-Profits Tax.*

A corporation whose entire income is derived from royalties on patents in which it has no investment is entitled to assessment under Section 209 as being engaged in a trade or business having no invested capital or not more than a nominal capital.

United States District Court, District of New Jersey.

De Laski & Thropp Circular Woven Tire Co.  
vs. Iredell, Collector.  
(268 Fed. 377.)

*(Note Supplementary Bulletin Rulings at Sec. 327, Art. 901-13, Ruling No. 17, and particularly the matter quoted there from T. B. M. 9.)*

**913** BODINE, District Judge. The plaintiff, a New Jersey corporation, has brought suit against the collector of internal revenue for the First district of New Jersey to recover an excess profits tax for the year 1917, alleged to have been improperly levied, assessed, and collected, and the defendant has moved to strike out the complaint, for the reason that—

“A corporation whose sole income is received from licensed patents is a corporation having more than a nominal capital, within the meaning of section 209 of the Revenue Act of October 3, 1917.”

**914** The complaint discloses that the plaintiff was incorporated in 1903, with an authorized capital stock of \$100,000. At the time of its incorporation its officers contemplated engaging in the business of manufacturing pneumatic vehicle tires of a peculiar and unusual construction. The Company experimented at great expense over a period of years, until it was determined that the manufacture of its tires was not commercially possible. One of the officers of the Company during the period of experimentation developed a new form of mold for vulcanizing pneumatic tires, which mold was of general utility, and a patent was secured, which was assigned to the Company for \$1, together with other patents relating to tire-manufacturing apparatus.

**915** In 1911 the Company ceased conducting any other business than that of granting licenses under its patents. Its capital was reduced to \$10,000. During the year 1917 the capital and surplus were \$10,000 and \$2,000, respectively, or a total invested capital of \$12,000, which capital was used as a fund from which to advance salaries, wages, etc., and to provide office furniture, accommodations, and equipment. The Company was in much the same position as an individual who, having invented a machine desired by others, received royalties for the use of his invention and kept sufficient money on hand to provide for his needs during periods when royalties would not be received. The Company's net income during the year 1917 was \$105,650.29. It is clear, therefore, that the patents had real value.

**916** The plaintiff concluded that it was entitled to be assessed under section 209 of the Revenue Act of 1917, on the theory that it was a



corporation "having no invested capital or not more than a nominal capital." The Treasury Department, however, acting under section 210 of the act, on the theory that it was unable to satisfactorily determine the invested capital of the plaintiff, assessed an additional tax, which was paid by the plaintiff under protest, and for the recovery of which this action is brought.

**917** Section 201 of the Revenue Act of 1917 provides that, in addition to an income tax, every corporation, except those specifically exempted, of which the plaintiff is not one, shall pay the additional tax upon its net income. The tax was graduated, and was a certain percentage of the net income, not in excess of certain fixed percentages of the invested capital. Under section 207 of the act the term "invested capital" is defined. It appears from this section that the plaintiff's patents would not be included in the term "invested capital," for the reason that no stock of the plaintiff Company was issued therefor, nor were these patents specifically paid for in cash or tangible property. The only invested capital of the plaintiff was the \$12,000 of capital and surplus, which was not used in the production of the net income of the plaintiff, but merely for the purpose of advancing salaries, wages, and providing office accommodations and equipment, and which in itself, under treasury ruling, would not bring the Company under section 201 of the act.

**918** In determining the question whether such a corporation, deriving its income solely from royalties or licenses from patents, can be said to be a corporation "having no invested capital or not more than a nominal capital," within the meaning of section 209, reference is made in behalf of the collector to the Congressional Record of October 6, 1917, containing a statement by Hon. Claude Kitchin, who was at that time chairman of the Ways and Means Committee. It appears from this statement that the Excess Profits Tax Law, as contained in the House Bill, applied only to corporations and partnerships, and not to individuals. The Senate brought within the scope of the law individuals in trade or business, but excluded lawyers, doctors, professional men, and officers of corporations, as well as governmental officers. The House conferees, it would seem from Mr. Kitchin's statement, opposed the inclusion of individuals, unless they were all brought in. The Senate insisted upon the exemptions, and section 209 of the act resulted, which, it is the claim of the collector, was intended to apply to a definite class of persons; i.e., lawyers, doctors, professional men, and high-salaried officers of corporations and the government.

**919** If this idea of providing especially for those rendering a personal service was all that was in the minds of the conferees, there seems to be no reason why they should not have used more exact language to convey their meaning, and further there is no reason at all why Congress should have specifically provided that, in a case of a trade or business "having no invested capital or not more than a nominal capital," there should be assessed a tax other than the tax to which such trade or business would otherwise be liable under section 201, unless there was to be a distinction between those employing "invested capital" and those employing "nominal capital." These terms admit of exact definitions.

**920** The determination of this case must, as already indicated, depend upon the meaning of the words "not more than a nominal capital." It is clear from section 207 that the patents from which the plaintiff derived its revenue cannot be regarded as "invested capital." Counsel for the plaintiff, in a most exhaustive and painstaking brief, has shown that the treasury rulings indicate that the word "invested" was omitted in the act

by oversight in the phrase "not more than a nominal (invested) capital." This suggestion, however, is not well taken, for the reason that, whatever the treasury rulings may have been, they can be given no force to modify or add to the clearly expressed language of Congress.

**921** It does not follow, however, that the word "capital" embraces patents. The following definitions of "capital" are in point:

"Wealth employed in or available for production." Funk & Wagnalls New Standard Dictionary.

"That part of the production of industry which, in the form either of national or of individual wealth, is available for further production." The Century Dictionary and Cyclopedia.

**922** The late J. S. Mill, the eminent economist, defines "capital" as follows:

"What capital does for production is to afford shelter, protection, tools, and materials which the work requires, and to feed and otherwise maintain the laborers during the process. *Whatever things are destined for this use, destined to supply productive labor with these various prerequisites, are capital.*" Political Economy, i, iv, § I. (The italics are mine.)

**923** Taking this last definition, which embodies the thought of all the others, it seems clear that patents do not fall within the term "capital;" and it also seems to be clear that this is what was in mind when Congress made the distinction between "invested capital," which is defined under section 207 to include the actual cash value of patents paid for in stock or shares, and also such other intangible property, which had been paid for in money or stock, and also what was in mind when the word "capital" is used alone in section 209, preceded by the word "nominal;" that is, in the sense of something in name only employed in or available for production. The distinction is between those employing those stored-up concrete things, essential to productive labor, and those employing these things existing in name only. Patents were never capital in an economic sense. Congress included them within the term "invested capital" to the extent only of the investment in them; if no investment in them, then they remain in the same class as that intangible something which makes for the wealth of the professional man, the broker, or others engaged in a personal service, which could never be "capital," except in name only.

**924** The decision of this case, however, need not depend solely upon the meaning of the word "capital," to be found in the distinction between "invested capital" and "nominal capital," as used in the act. The patents which the plaintiff owned were the concrete embodiment of the skill which the plaintiff possessed in its field of activity. This skill or service it bartered for a consideration. Such skill or service is like the service a lawyer in large practice renders for an annual retainer, and is very nearly akin to the service which a commission house renders to those who buy and sell through it, or the service of a concern engaged in selling or leasing real estate, and in writing insurance. The plaintiff's source of income was that which certain persons were willing to pay it for the use of its skill and knowledge. It is true that skill and knowledge had been reduced to concrete form; but the payment was for the use of the skill and knowledge, and not for any part or parcel of the form to which the skill and knowledge had been reduced. Hence it would seem that in a very real sense the plaintiff was engaged in rendering a personal service, and was not employing "capital," and certainly no more than a "nominal capital."

**925** The motion to strike is dismissed.



*(Decision.)*

Revenue Act of 1917.

**Additions to surplus account; Earned surplus expended in developing and improving a secret process, or used to repay borrowed money so expended.**

UNITED STATES DISTRICT COURT, SOUTHERN DISTRICT OF NEW YORK.  
Lincoln Chemical Company, Plaintiff,

against

William H. Edwards, as Collector, etc.

(272 Fed. 142.)

**926** Action by a taxpayer against the Collector for refund of a part of  
**771** the excess profits tax for 1917. The plaintiff, a domestic corporation,  
**772** filed its return for 1917 and calculated its capital upon the basis of  
 Section 209 of the law of October 3, 1917; that is to say, it assumed  
 that it had "no invested capital or not more than a nominal capital." The  
 Treasury officials reassessed the tax at a larger figure upon a basis not now  
 necessary to set forth, because it is conceded that the propriety of their  
 action depends upon the correctness of the plaintiff's reading of Section 209.  
 If that is right, the plaintiff wins; if it is wrong, the defendant.

**927** The case was tried before a jury of one, and at the conclusion of the  
 evidence both sides moved for the direction of a verdict. The evi-  
 dence, which was undisputed, showed the following state of facts: The  
 plaintiff was organized in April, 1909, under the laws of New York, with a  
 capital stock of ten thousand dollars. There were but two persons financially  
 interested in it, Loeb and Riddle. Riddle was an inventor, and before the  
 incorporation came to Loeb with a process for extracting cocoa butter out  
 of cocoa shells, a by-product. This process proved worthless, and Riddle  
 thereupon suggested to Loeb the possibility of converting the process into  
 one from which he could extract from cocoa shells a chemical substance,  
 known as theobromine, allied to caffeine. Loeb, having some money, con-  
 tinued to advance it in defraying Riddle's further experiments, until he  
 became fearful of two wide involvement, and determined to incorporate the  
 venture. Riddle agreed to work for the corporation for five years at a salary  
 of eighteen hundred dollars and to convey his process, still unperfected,  
 both for twenty-four hundred dollars par value of the plaintiff's stock. Loeb  
 agreed to convey the machinery and supplies par for par in stock, seventy-  
 four hundred dollars, and two hundred dollars was paid in cash.

**928** During the year 1910 the company borrowed nearly twenty thou-  
 sand dollars, which it spent in Riddle's further experiments upon the  
 process, which was then complete. During that year it got one Schaefer, a man-  
 ufacturing chemist, to make a contract for the exploitation of the process on a  
 royalty basis, but the sales of theobromine were so few that the royalty was  
 never earned. In 1912 they got Schaefer to give them better terms; he  
 agreed to pay two thousand dollars a year for the process over a period of  
 fifteen years and to furnish theobromine to the plaintiff at \$2.50 a pound,  
 or less. This gave the plaintiff control of a supply without manufacturing.  
 At the time of the first contract in 1910, the plaintiff sold all its machinery  
 and plant to Schaefer for \$1,155, and its supplies for \$407, and this money  
 was either used in development or upon the indebtedness. In any event,  
 it had all disappeared before 1914. The plaintiff never manufactured any  
 theobromine after 1910.

**929** The plaintiff's profits on the sale of theobromine made by Schaefer under the process were not large throughout the year 1911, but they began to increase in 1912 and 1913, and the company thus made a small income besides the royalty paid by Schaefer. The advent of the Great War in 1914 greatly increased the demand, and the business became very profitable, so that by January 1, 1917, all its debts were paid and it had a surplus of thirteen thousand dollars after writing off a depreciation of seven thousand seven hundred dollars upon the process.

**930** The business was done as follows: There were but three purchasers of theobromine, all large manufacturing chemists, who bought at ten days' cash. The plaintiff necessarily bought all its theobromine (made under the process), from Schaefer at fifteen days cash, and was therefore in a position to pay Schaefer out of the moneys which its customers paid to it. As these were of high financial responsibility it had no need to hold a reserve in its treasury, in order to finance its purchases, though at times, when in ample funds, it did use its surplus to pay Schaefer before the customers paid for their consignments.

**931** During the year 1917 the assets of the plaintiff, therefore, consisted only of its cash on hand, the contract with Schaefer, and the secret process finally perfected by Riddle. Its stock was ten thousand dollars, and its surplus as stated, thirteen thousand dollars, of which over seven thousand dollars was in cash. It necessarily followed that its other assets were valued at sixteen thousand dollars.

**932** The case depends upon the meaning of the phrase "invested capital" and "nominal capital" as used in Section 209 and as defined in Section 207. The plaintiff asserts that there was only two hundred dollars of cash paid in, no tangibles remaining after 1913, no surplus "used and employed" in the business, and that the secret process was an "intangible" which must be taken at its "actual cash value" in April, 1909, which is shown to be nothing. The defendant argues that the sums spent upon the process which did in fact increase its value by nineteen thousand dollars should be taken as a surplus "used and employed" in the business.

**933** **LEARNED HAND, D. J.:** I shall decide this case upon the assumption that "nominal capital" in Section 209 means "nominal invested capital," without of course passing upon that question. I shall further assume—and indeed on this point both sides agree—that the secret process of Riddle was "intangible property" within the meaning of Section 207 (a) (3) (b). I shall finally assume that the process had only a nominal value in April, 1909, when it was sold to the plaintiff for twenty-four hundred dollars of stock. With these assumptions the question arises whether the money used to develop the process can be regarded as "paid in or earned surplus and undivided profits used or employed in the business" under Section 209 (a) (3). On the trial I thought that the plaintiff was right on this point, and for clarity I shall therefore state its argument as strongly as I can. The statute, it says, prescribes that "intangible property" of this kind "shall be included in invested capital at a value not to exceed the actual cash value at the time of such purchase." Disregarding "paid in surplus," of which there is none here, the "earned surplus" is the only item into which the supposed added value of the process can be placed. Now surplus, or at least "earned surplus" is merely an accountant's way of saying that the value of the assets are greater than the liabilities. When the statute



speaks of "invested capital," it must be understood to refer to existing property, i. e. "means of production," and to use accountant's language, not because accounts can ever of themselves be the basis of taxation, but because they are the most convenient record of actual values, embodied in property which is alone the proper basis of taxation. "Earned surplus" must therefore represent the value of existing property.

**934** This being true, continues the plaintiff, the only asset of value in 1917 was the perfected process and we may assume that it had enough value to give more than a "nominal" "earned surplus" above the capital stock, which was the only liability. Therefore, if the asset could be taken at its true value in 1917, Section 209 of the statute would not apply. The difficulty with the Collector's position, however, is that Section 207 directed us to include the process at no more than its "actual cash value" in 1909, and at that time it had none. The money spent in improving and perfecting the process had, in 1917, no existence at all, save in the process itself. It was spent in machinery or supplies or Riddle's living expenses, or salaries. So far as our treasury was concerned there was nothing now left except the process. That was therefore the only asset which could figure on the credit side of our account to establish any "earned surplus," and the statute forbade its inclusion at anything but a nominal value. Therefore, we had no "earned surplus," and only a "nominal invested capital."

**935** This argument appears to me unanswerable if the incompleting process be regarded as the same asset for all purposes when finally developed as when first acquired. The statute must of course mean something, and the least that it can mean must be, I think, that any automatic increase in value of a process or "other intangible property," must be disregarded. The "unearned increment," as economists would call it, will be ignored. Therefore, I should altogether disregard any increase in the value of this process dependent upon general conditions of industry, as for example the rise in the price of theobromine due to the Great War. Furthermore, for the purposes of this case, anyway, I may assume that an increase in the value of the process, resulting from spending money in advertising or the like, which leaves it unchanged in itself, will fall into the same category. That question can await decision till it arises; I say nothing about it here. The case at bar is, however, one where money has been spent in changing the property itself, so that in place of a formula which prescribed one sequence of steps, there emerged another which prescribed a different sequence. Fair analogies appear to me, for example, cattle fed for market, or houses rebuilt or enlarged. It is true that for convenience we speak of such property as always remaining the same, though in fact it is not only different in value, but that difference results from a change in the objective character of the property itself, but that convenience should not disguise the substantial fact that it is, economically speaking, new property which appears.

**936** When such changes have resulted from the expenditure of new capital, I see no reason why the statute should be construed as peremptorily directing that they should be disregarded. It is quite true still, as the plaintiff argues, that the "earned surplus" must be found in some assets and that the only asset in the case at bar still remains the process, but it is a different process. The limitation of Section 207 may be confined, without undue violence to the sense of the words, to such increases in value as arise without the addition of new capital, and it may be, to such others also as involve no objective change in the thing itself.

**937** Indeed, it can scarcely be supposed that Congress could have had any other purpose than to prevent the taxpayer from crediting his capital account with increases which he had done nothing to produce. If they meant to include also new outlays upon existing capital, no matter how providently made, the statute provides a direct incentive to extravagance. Often, perhaps generally, it is a sound industrial policy to improve existing capital, rather than to scrap it, and invest anew. Yet if the plaintiff be right, no such investment can ever do more than meet depreciation, and this would apply as well to "tangibles" as to "intangibles." The only new values which could be recognized would be in property bought outright after incorporation, and those investments which may have been the means of changing the industrial character and value of existing property, would be totally lost for purposes of taxation. When taxes can be as high as the excess profits tax may be, such inducements may become a patent influence upon industrial conduct, and it cannot be supposed that the result of the plaintiff's construction was within the purposes of Congress.

**938** Again, it should be a weighty consideration with me that the Tax Bureau has made these allowances in the past in the case of thousands of taxpayers and has drafted its regulations upon the assumption that the statute permits them. I therefore hold that when money has been earned and spent in improving a process such as this, its increased value due only to that expenditure may figure as an asset in estimating under Section 207 "earned surplus," if any, as an element of "invested capital."

**939** It does not follow, of course, in the case at bar that the value of the process so improved was enough to cause any "earned surplus" to emerge. That depends upon whether the assets, so estimated, were greater than the stock, ten thousand dollars, by more than a "nominal" amount. Now the value of the "tangibles" must under Section 207 be taken as of January 1, 1914, at which time they had disappeared. Therefore, the process must have increased from its nominal value in 1909 to more than ten thousand dollars before any "earned surplus" could begin to appear at all. The value at which the plaintiff carried the process does not definitely appear on its books. On January 1, 1917, it had a surplus of \$13,088.59 and therefore assets of \$23,088.59. Of this, \$7,367.64 was in cash, leaving \$15,720.95 for other assets which must be the process and the contract. The contract got its value only from the process and may be disregarded. The value of the process as of that year would therefore appear to be this sum.

**940** This figure, it is true, does not correspond with other evidence and apparently is incorrect. In its income tax return for 1916 it valued the process as of March 1, 1913, at \$19,716.84, and claimed a deduction for depreciation to date of \$7,761.42, leaving a value of about \$12,000 as of January 1, 1917. The discrepancy of some \$3,700 I have been unable to account for except upon the hypothesis that there were other assets not shown. Perhaps the cash was greater, because the cash book showed a balance on January 2, 1917, of \$11,000 which just about makes up the difference. Assuming that this is the proper explanation, still on the plaintiff's own admission it had an "earned surplus" of \$2,000 which in view of the size of the business I should not consider "nominal."

**941** But the defendant was not bound by the plaintiff's admission. It was for the plaintiff to prove that it had only a nominal capital. The process was clearly of very substantial value. The contract had ten years more to run and there was a minimum royalty of \$2,000. Besides this the plaintiff could call for at least three thousand pounds of theobromine



yearly at not more than \$2.50 a pound, a right which had been of substantial value in the years before the war began to affect the price. In 1914 this right was worth \$525 and the royalty apparently \$2,854. Moreover, when the contract terminated the process would not necessarily become worthless. Indeed it may have a very substantial value for an indefinite time. The plaintiff has certainly failed to prove that its value in 1917 over \$10,000 was "not more than nominal."

**942** I therefore conclude that the case is not proved and will direct a verdict for the defendant. (The foregoing is reproduced in T. D. 3183 not as a ruling, but for information. The case is reported at 272 Fed. 142.)

(Decision.)

(Revenue Act of 1917.)

(277 Fed. 150.)

Borrowed capital in relation to the "no invested capital or not more than a nominal capital" provision of Section 209 of the 1917 Act.

UNITED STATES CIRCUIT COURT OF APPEALS  
Sixth Circuit.

CHARLES E. CARTIER and EDWARD M.  
HOLLAND, Co-partners doing business under  
the firm name and style of Cartier-Holland  
Lumber Company,

*Plaintiffs in Error,*

vs.

EMANUEL J. DOYLE, United States Collector  
of Internal Revenue for the Fourth Col-  
lection District of Michigan,

*Defendant in Error.*

ERROR to the District Court  
of the United States for  
the Western District of  
Michigan, Southern Di-  
vision.

(No. 3541.)

Before KNAPPEN, DENISON and DONAHUE, Circuit Judges.

**943** On the 20th day of May, 1912, Charles E. Cartier and Edward M.  
**566** Holland, entered into a written contract of partnership for the  
purpose of manufacturing and dealing in forest products including  
lumber, timber, ties, shingles, laths, etc., and also timbered, improved and  
cut-over lands.

**944** It was further agreed that the paid-in capital of the partnership  
should be thirty thousand dollars, any portion or all of which amount  
should be furnished to the partnership by Charles E. Cartier, as the require-  
ments of the partnership appear upon the note or notes of the partnership  
to be paid at the earliest practicable opportunity out of the net earnings of  
the partnership business, and to bear legal rate of interest.

**945** It does not appear from the evidence that this partnership ever  
manufactured any forest products but it did purchase lumber and  
kindred commodities to fill current orders of its customers but not for specu-  
lative purposes based upon rise and fall of the market. It kept no lumber

yard and kept no lumber in stock, and the only lumber owned by it was lumber in transit from the mill from which it was purchased by the partnership, to the partnership's customers. In a few cases, however, where the lumber was rejected by the customer it was held by the partnership until it could be sold to another purchaser. In 1917 the partnership also negotiated sales for timber and secured an option on a larger acreage of timber land in its own name, but in fact for William and Samuel Horner, who furnished the thousand dollars necessary to be paid for this option and the additional five hundred dollars necessary to extend the option beyond the sixty days named therein.

**946** For services in this transaction the partnership received \$20,353.00, which is by far the largest single item in the aggregate of the net income of \$47,018.00, earned by the partnership in 1917.

**947** It further appears from the record that after the organization of the partnership which was known as the Cartier-Holland Lumber Company, Cartier did furnish it some money and took its notes therefor, but in 1914 a new arrangement was entered into by which the partnership borrowed the money required in its business directly from the bank and executed its notes therefor. These notes were indorsed by both Cartier and Holland, and Cartier left upon deposit with the bank, as collateral to his indorsement of these notes, securities theretofore deposited by him when he borrowed the money in his own name and loaned it to the partnership. It was also further understood and agreed between the bank and the partnership, when these loans were negotiated, that if at any time the collateral deposited by Cartier seemed to the bank to be insufficient to cover his liability as indorser on the notes of the partnership, Holland would furnish further collateral security. This method of transacting the partnership business was continued until and during the year 1917 and in this way the partnership obtained all its capital including the money required by it to discount its bills for lumber and other commodities purchased by it and sold to its customers.

**948** It further appears that during the time the partnership was operated Cartier drew out of the partnership business \$11,556.37 and Holland \$18,106.28, which amounts were charged to them on the books of the partnership. If these amounts withdrawn by the partners are reckoned as assets of the partnership, then on January 1, 1917, there was a net surplus of assets over and above liabilities of \$22,443.80; otherwise the liabilities of the partnership would exceed its assets by the sum of \$7,218.85.

**949** The partnership paid an excess profit tax of eight per cent of its net income of \$47,018.00, for the year 1917 under the provisions of Section 209 of Title II of the Act of October 3, 1917, amounting to \$3,761.44. Later a supplemental return was requested by the Commissioner of Internal Revenue, who then notified the partnership that its claim for assessment based upon the provisions of Section 209 of the Excess Profits Tax Law had been disallowed and that the tax had been computed and assessed against it under Sections 201 and 210 and Articles 18, 24 and 52 of Regulation No. 41.

**950** This tax based upon an estimated capital of \$118,515.85 amounted to \$12,788.90, or a balance over the amount already paid of \$9,027.46, which additional tax was paid under protest. Later the partnership brought an action in the District Court of the United States for the Western District of Michigan, Southern Division, to recover the additional tax levied and



demand by the Internal Revenue Commissioner and paid by it under protest.

**951** The parties having expressly waived a jury, the cause was submitted to the District Court upon the pleadings and the evidence, resulting in judgment for the defendant. Findings of fact were submitted by the plaintiff and defendant, but the court refused to adopt these findings or either of them, and ordered that its opinion should constitute its findings of fact and conclusion of law, to which findings, conclusion and judgment, exceptions were taken by the plaintiff in error.

**952** DONAHUE, Circuit Judge: The only question presented by this record is whether or not the partnership of Cartier-Holland Lumber Company during the year 1917 had an invested capital within the meaning of Section 201, 207 and 210 of Title II of the Act of Congress approved October 3, 1917.

**953** If this question were to be determined separate and apart from the act levying this excess profit tax, then it would be of easy solution. Money invested in a partnership business, whether paid in by the partners or borrowed from a partner or a bank, in the absence of legislation to the contrary, would constitute invested capital in the ordinary meaning and acceptance of that term. Congress, however, evidently for the purpose of protecting the government from claims of inflated capitalization, thought it wise and necessary to define the term "invested capital," which is made the basis of the computation of the tax to be levied under the authority conferred by this Act. To that end Section 207 provided among other things the following:

"As used in this title 'invested capital' does not include stocks, bonds (other than obligations of the United States), or other assets, the income from which is not subject to the tax imposed by this title nor money or other property borrowed, and means, subject to the above limitations:

"(a) In the case of a corporation or partnership: (1) Actual cash paid in, (2) the actual cash value of tangible property paid in other than cash, for stock or shares in such corporation or partnership, at the time of such payment (but in case such tangible property was paid in prior to January first, nineteen hundred and fourteen, the actual cash value of such property as of January first, nineteen hundred and fourteen, but in no case to exceed the par value of the original stock or shares specifically issued therefor), and (3) paid in or earned surplus and undivided profits used or employed in the business, exclusive of undivided profits earned during the taxable year: \* \* \*"

**954** In the construction of the Act of Congress of which this definition is a part, this legislative definition of the term "invested capital" must be accepted as final and conclusive, regardless of any preconceived notion the public generally, or this court, may have as to the meaning of that term.

**955** In the construction of this statute it must also be remembered that it is the settled rule not to extend the provisions of taxing statutes by implication, or to enlarge their operation, so as to embrace matters not specifically covered thereby. *Gould v. Gould*, 245 U. S. 141.

**956** The trial court based its judgment for the defendant upon the conclusion of law that the collateral deposited by Cartier as security for his liability as an indorser of the partnership notes became a part of the working capital and was used and employed in the business of the company to the same extent as if it had been paid directly into the partnership funds.

**957** This conclusion of law is not supported by the facts found by the court or by any evidence in this record. The articles of co-partnership provide that the paid-in capital of the partnership is to be \$30,000.00, any or all portions of which amount is to be furnished to the partnership, upon notes signed by it, and to be paid at the earliest practicable opportunity out of the net earnings of the partnership.

**958** It would seem unnecessary to say that a private contract between these parties would not change or affect, in the slightest degree, the plain and positive terms of the statute, declaring what shall be included and what shall not be included as "invested capital," for the purpose of this tax. If the articles of co-partnership had provided that the paid-in capital of the partnership should be \$30,000.00, one-third of which should be paid in cash or in property by the partners, and \$20,000.00 to be borrowed from a bank upon the notes of the partnership, indorsed by the partners, and further secured by the deposit of such collateral as the bank might demand, the money borrowed in pursuance of such partnership agreement, fixing the total capital of the partnership at \$30,000.00, would necessarily be rejected as invested capital in the computation of surplus income taxes levied under this act. It logically follows that, if under this statutory definition of invested capital, money borrowed could not be included as capital where some substantial amount of cash had actually been paid into the partnership fund by the partners, such borrowed money can not be reckoned as invested capital where the partners contributed neither cash nor property to the partnership capital.

**959** The original plan of operation written in the partnership agreement was abandoned as early as 1914, and thereafter the money used in the partnership business was borrowed directly from the bank upon the notes of the partnership, payable unconditionally and at certain fixed times, regardless of net earnings or any other contingency. While these notes were indorsed by the individual partners, nevertheless the money was borrowed by the partnership for partnership purposes, and it was primarily liable for the payment of these notes. Collateral held by the bank, a stranger to the partnership, whether the property of one or of both partners, was a mere incident to the loan, and can in no wise affect the character of the transaction.

**960** It is therefore wholly unnecessary to determine whether under the original agreement the money to be furnished by Cartier, to be repaid out of the partnership earnings, would or would not be borrowed money within the meaning of this act. Nor is it important at whose suggestion this plan of operation was changed and the new plan adopted. It is sufficient for the purposes of this opinion to determine the legal effect of these transactions as they occurred during the taxing period of 1917. The evidence in relation to these transactions permits of no conclusion other than that the money borrowed from the bank upon the notes of the partnership was "borrowed money," within the meaning of Section 207 of the Act of Congress approved October 3, 1917.

**961** The clear, positive and unambiguous language of Section 207 of this act is not subject to any other construction, regardless of the exigencies of any particular case. First it provides that borrowed money or other property shall not be included in the term "invested capital" as used in that title. Paragraph "A" of that section then specifically states what shall be included in determining the "invested capital" of a corporation or partnership as follows: "(1) Actual cash paid in." There is no claim made by the government that there was any "actual cash paid in" to the partnership funds



other than the money borrowed from the bank on the notes of the partnership, endorsed by the partners, the endorsement of Cartier being secured by collateral deposited by him. "(2) The actual cash value of tangible property paid in other than cash for stock or shares in such corporation or partnership." In this case there was no tangible property paid in by either partner for the purpose named or for any other purpose. The collateral deposited by Cartier could not upon any reasonable hypothesis be held to be "tangible property paid in" to the partnership. It was not deposited with, transferred or assigned to the partnership and the partnership never acquired any right, title or property interest therein, legal or equitable. This collateral was deposited with the bank as part of the loan transaction. Cartier never parted with the title or ownership therein. The bank held it, not as owner but as pledgee merely. "(3) Paid-in or earned surplus and undivided profits used or employed in the business exclusive of undivided profits earned during the taxable year."

**962** Whether this partnership used or employed in its business paid-in or earned surplus and undivided profits exclusive of undivided profits earned during the taxable year is a question of fact. The trial court found as a fact that at the beginning of the taxable year the liability of the firm exceeded its assets by the sum of \$7,218.85. This court has no authority to determine the weight of the evidence. R. S. Sections 649 and 1011. If the finding of fact made by the trial court is sustained by some substantial evidence, then it must be accepted by this court as a final determination of the facts in issue.

**963** There is practically no dispute in the evidence upon which the trial court made this finding of fact. It had been the custom of each partner, with the consent of the other, practically from the time the partnership was organized, to withdraw earnings of the partnership in advance of the ascertainment of the exact profits and a formal division of the same. These withdrawals were charged against the partners respectively on the partnership books of account, and whenever there was a formal division of the profits the amount due to each partner was credited to his account as against amounts that were withdrawn by him. On the first day of January, 1917, it appeared that Cartier had withdrawn in the aggregate, during the life of the partnership, the sum of \$11,556.37, in excess of all sums credited to him. Holland had also withdrawn \$18,106.28 in excess of his credits. The evidence further shows that these withdrawals were made in anticipation of a distribution of the profits, to be credited to them as against these withdrawals, that would finally balance their accounts. That this was the purpose and understanding of the partners fully appears by their testimony and particularly the testimony of Holland, as follows:

"The Court: It would be liquidated by dividends you declared?"

"A. Eventually."

"The Court: And credited yourself with?"

"A. Yes."

**964** In the absence of an express agreement to the contrary, the partnership could not require a partner to return to it his share of the actual profits anticipated by these withdrawals. The strongest inference which anything in this record would justify as to the duties of the partners to each other to repay these items charged against them is that each should repay the amount he had withdrawn in excess of his share of the profits. This would mean in the aggregate \$7,218.85, just enough to pay the general debts and leave no surplus. In any event, these profits were drawn by the

partners and were not used in the partnership business. The claim that they were used in the partnership business as bills receivable, so they would furnish a basis of credit, is not tenable. These partners were the sole owners of the partnership business and in full control of its affairs; they were each individually liable for all the debts of the partnership, so that whether they were liable to the partnership for the full amount of these withdrawals, regardless of profits, could in no wise affect the security of creditors for the payment of their debts.

**965** It would therefore appear that this finding of the trial court is fully sustained by substantial evidence.

**966** Section 9 [209] of this act provides that in the case of a trade or business having no invested capital (and, of course, that means invested capital within the meaning of the act), or not more than a nominal capital, there shall be levied, assessed, collected and paid, in addition to the taxes under existing law and under this act, in lieu of the tax imposed by Section 201, a tax equivalent to eight per centum of the net income. This section of the act would appear to have been intended to cover just such conditions as are here presented.

**967** For the reasons above stated, this judgment must be reversed and the cause remanded for a new trial in accordance with this opinion. [The District Court decision is reported at 269 Fed. 647.]

#### **968 Revenue Act of 1917: Decision of Court: Invested Capital: Selling**

**566 Agent: Taxability Under Section 209.**—Plaintiff corporation acted as sole agent for a mining company under an arrangement contemplating that it should discount drafts in the case of foreign shipments and pay the amount of the invoices in the case of domestic shipments, retaining in both cases only commissions and interest, so that the principal was constantly in the corporation's debt for advances. The corporation was incorporated for \$25,000, and in 1917 had capital, at the beginning of the year, of \$51,074, and income of \$26,890.34 from commissions from selling for account of its principal, \$22,133.25 profits from buying and selling on its own account, and \$5,851.90 from interest. In 1915, the proportion of gross profits from trading on its own account was 23%; in 1916, 9.8%; and in 1917, 45%. Its profits during 1917 were retained, and not distributed as dividends, and its officers made substantial advances to aid it in financing the business. The capital of the corporation was not used merely to pay ordinary expenses, but to assist in paying advances to its principal, as well as to trade on its own account. During 1917 its capital was engaged in its business and was being turned over in connection with sales, its advances including capital available or capital repaid from advances. On December 31, 1917, when its bank balance was larger than in any other month of the year, it was only \$16,501.67, while its capital and surplus amounted to \$78,330. Held, that such corporation did not merely buy and sell on commission but traded substantially on its own account, and had a substantial invested capital which was employed in making advances to or on account of its principal, and also in buying merchandise on its own account for profitable sale, and hence it was not entitled to assessment under Section 209 of the Revenue Act of 1917, which applies only to businesses having no invested capital or not more than a nominal capital.

**969** The decision [syllabus only, ¶968 above] of the United States District Court for the Southern District of New York, rendered March 10, 1922, in the case of R. H. Martin, Inc. v. William H. Edwards,

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Collector, the syllabus of which appears above is published not as a ruling of the Treasury Department, but for the information of internal revenue officers and others concerned. (T. D. 3334, signed by Commissioner D. H. Blair, and dated May 25, 1922.)

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**970 to 999 Blank.**

**1000** For ¶1000, at which the Excess-Profits Tax Title of the Revenue Act of 1921 begins, see page 401, immediately following the Supplementary Bulletin Rulings.

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WAR TAX SERVICE

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# Reprints of Profits-Taxes Rulings From The Internal Revenue Bulletins.

## FOREWORD

Early in 1920 the Government published its 1919 Cumulative Bulletin of Special Rulings, which rulings had been issued confidentially during 1919 for the exclusive use of the Bureau's employees. During 1920 by a change of policy, continued in 1921 and 1922, rulings were made public week by week. So far as appears, the Bulletins will continue to issue during 1923.

On the pages following are reproduced in full, verbatim as originally published by the Government in the Bulletins mentioned above, those rulings having specific application to the War-Profits and Excess-Profits Tax Titles of the Revenue Acts of 1918 and 1921. This Supplement (and that it is a supplement must be borne in mind constantly) will be up-to-date at all times.

Rulings based on the 1917 Acts are included to the extent that they are applicable, directly or indirectly, to the provisions of the 1918 and 1921 Acts, but not otherwise. Excluded rulings relate in very large measure to the former tax on individuals.

Rulings bearing on provisions of the 1918 law applicable now to a restricted degree only, or entirely inapplicable now, are nevertheless included.

The table below is explanatory of the abbreviations used by the Bureau.

A, B, C, etc.=The names of individuals.

A. R. M.=Committee on Appeals and Review Memorandum.

A. R. R.=Committee on Appeals and Review Recommendation.

C. B.=Cumulative Bulletin.

Ct. D.=Court Decision.

I. T.=Income Tax Unit.

M, N, X, Y, Z, etc.=The names of corporations, places, or businesses, according to context.

Mim.=Mimeograph Letter.

O. or L. O.=Solicitor's Law Opinion.

O. D.=Office Decision.

Op. A. G.=Opinion of Attorney General.

S.=Solicitor's Memorandum.

Sol. Op.=Solicitor's Opinion.

T. B. M.=Advisory Tax Board Memorandum.

T. B. R.=Advisory Tax Board Recommendation.

T. D.=Treasury Decision.

x is used to represent a certain number, and when used with the word "dollars" represents a sum of money.

Each Special Bulletin ruling is cited to its source. In the 1919, 1920 and 1921 series the rulings are cited as follows: 29-20-1081: A. R. M. 71. This particular ruling, then, is the 71st memorandum of the Committee on Appeals and Review, is the 1081st ruling made, and was first published in Bulletin No. 29, of the 1920 Series. A new series of ruling numbers (beginning with ruling 1) was started with the first issue of 1922. Each Bulletin issue is designated by a number, as 1, 2, 3, etc., and the 1922 group of weekly issues is embodied in "Volume I," and that for 1923 in "Volume II." The old numbering following the letters characterizing the rulings, as A. R. M. 145, is continued; i. e., a new series is not started. However, the old characterization of "O. D." is dropped, "I. T." being substituted. Thus: I-1-14: I. T. 1155, is the 1155th ruling of the Income Tax Unit (in effect the 1155th O. D., or office decision), is the 14th ruling made in 1922, and was first published in Bulletin No. 1, of Volume I of the Internal Revenue Bulletin (i. e., Bulletin No. 1 of the 1922 Series).

Each special ruling when originally published is assigned to a particular Article of Regulations 45 or of Regulations 62. (See "Caution" on the perpetual check sheet facing page 401.)

We continue this assignment in the Supplement, giving to each Article its separate page or series of pages, where the special rulings assigned to it are reproduced in the order of their issue.

The rulings appearing under each Article are numbered serially, by us, in bold face type, as **1, 2, 3**, etc., the serial number appearing in each case, at the end of the ruling, on the left.

The Articles of Regulations 45 and 62, referring to the 1918 and 1921 profits tax laws, respectively, as the reader knows, are grouped under the respective Law Sections. The grouping is clearly shown in the Tables of Contents, beginning on pages 316 and 425, respectively.

The number of each Article of Regulations 45 (beginning on page 318), and the number of each Article of Regulations 62 (beginning on page 427) is clearly shown in bold face type. Thus may one turn quickly to the Bulletin Rulings bearing on any particular Article, as the Article number captions on the Supplementary Bulletin Rulings pages are in sequence.

The Supplementary Bulletin Rulings Pages are not numbered. As stated before each Article has its page or series of pages—as Sec. 326, Art. 850.-1, or -2, -3, -4, etc., and each special ruling is numbered serially. On the last page of the Supplement, immediately preceding the blue pages on which is printed the Excess-Profits Tax Law for 1921 (Revenue Act of 1921), is an always-up-to-date table, giving a complete list of existing Article numbers, showing, by serial number, either the *last* published Special Ruling assigned to that Article number, or stating by use of the word “none” that there have been no Special Rulings assigned to certain articles. Thus is there a perpetual, automatic check on the completeness of the Supplement.

Unless otherwise noted, all rulings are based on the provisions of the 1918 Act and the formal regulations relating thereto.

### **Very Important Caution.**

The following is printed on the front cover of each Internal Revenue Bulletin published by the Government.

“The rulings reported in the Internal Revenue Bulletin are for the information of taxpayers and their counsel as showing the trend of official opinion in the administration of the Revenue Acts; they have none of the force or effect of Treasury Decisions and do not commit the Department to any interpretation of the law which has not been formally approved and promulgated by the Secretary of the Treasury. Each ruling embodies the administrative application of the law and Treasury Decisions to the entire state of facts upon which a particular case rests. It is especially to be noted that the same result will not necessarily be reached in another case unless all the material facts are identical with those of the reported case. As it is not always feasible to publish a complete statement of the facts underlying each ruling, there can be no assurance that any new case is identical with the reported case. As bearing out this distinction, it may be observed that the rulings published from time to time may appear to reverse rulings previously published.

“Officers of the Bureau of Internal Revenue are especially cautioned against reaching a conclusion in any case merely on the basis of similarity to a published Income, Sales, Capital-Stock, Estate, Child-Labor, or miscellaneous tax ruling, and should base their judgment on the application of all pertinent provisions of the law and Treasury Decisions to all of the facts in each case. The Income and Sales Tax and other rulings should be used merely as aids in studying the law and the Treasury Decisions.”



**Law Section 301.—Imposition of Tax (1918 Act—¶510 ante): (1921 Act—¶1011, post).**

**Article 711.—Imposition of Tax (Reg. 45—¶598, ante): (Reg. 62—¶1135, post).**

21-21-1655: O. D. 928.

When a corporation may deduct the amount of its net operating loss for the calendar year 1919, which is in excess of the net income for the calendar year 1918, in computing net income for the calendar year 1920 in accordance with section 204 of the Revenue Act of 1918, the excess profits tax imposed by section 301 and limited by section 302 is upon the net income so determined.

1





**Law Section 301.—Imposition of Tax (1918 Act—¶510 ante): (1921 Act—¶1011, post).**

**Article 714.—Computation of Tax on Income from Government Contracts (Reg. 45—¶604, ante): (Reg. 62—¶1137, post).**

1-19-113: T. B. M. 4.

In the case of a fiscal-year corporation the computation under section 301 (c) (1) should be based on the entire net income for the fiscal year even though no part of the income from Government contracts was derived after January 1, 1919.

The following question has been submitted:

In the case of a fiscal-year corporation should the excess tax for 1919 based on income from a Government contract be prorated to apply only to income attributable to that contract in 1919, or should the tax be computed on the basis that the income was received throughout the fiscal year?

The computation under section 301 (c) (1) of the Revenue Act of 1918 should be based on the entire net income for the taxable year, or, in other words, should be on the basis that the income was received throughout the fiscal year. In the judgment of the board any other ruling would be in conflict with the express provisions of the statute. It is a fundamental principle of the application of the provisions of the several acts relating to fiscal years that no adjustment should be made even though it can be definitely shown what proportion of the income was derived during each portion of the fiscal year.

1

24-19-557: O. D. 295.

A Government contract entered into in 1917, amended as to some of its provisions in 1918, and further modified in 1919, is in effect the same contract as entered into in 1917 if the original contract has not been revoked or supplanted by a new contract. Therefore, income derived from the contract should be computed in accordance with the provisions of subdivision (c) of section 301.

2

28-19-620: A. R. M. 5.

If a corporation has a net income from a Government contract and sustains a net loss from other operations in the submission of a fiscal year return for a period ending in 1919, the loss may be deducted from the income from the Government contract.

Inquiry is as to the amount of net income to be taxed in the case of a fiscal-year corporation submitting a return for a period ending in 1919 if there is profit from a Government contract and loss from other operations.

Section 301 (c) of the Revenue Act of 1918 provides:

For the taxable year 1919 and each taxable year thereafter there shall be levied, collected, and paid upon the net income of every corporation which derives in such a year a net income of more than \$10,000 from any Government contract or contracts made between April 6, 1917, and November 11, 1918, both dates inclusive, a tax equal to the sum of the following: \* \* \*

It is to be noted that the tax is upon the net income of the corporation. The prorating in parts 1 and 2 of paragraph (c) of this section is purely for computation purposes. Accordingly, it is recommended that a corporation having a net loss from operations other than those relating to Government

contracts, and a profit from Government contracts, be permitted to deduct the loss in order to ascertain the net income upon which the tax is to be computed.

3

2-20-666: O. D. 359.

A corporation which contracted with another corporation to manufacture and deliver machinery to be used in manufacturing ammunition, but did not produce or furnish ammunition or any component part thereof, nor perform any direct service in connection with the production of ammunition manufactured by another corporation under contract for the United States Government, is not a subcontractor within the meaning of section 1, Revenue Act of 1918.

4

3-20-695: O. D. 378.

The excess profits credit and the war profits credit, as provided in section 301 (c) 1, Revenue Act of 1918, and article 714 of Regulations 45, are computed on the basis of the invested capital for the taxable year, not on the invested capital for 1918.

5

12-20-791: O. D. 412.

A contract between the Government and a corporation which was entered into and enforceable against the corporation prior to April 6, 1917, but which was not executed in the form prescribed by section 3744, Revised Statutes, so as to become enforceable against the Government until after that date, is not a "Government contract" within the meaning of that term as defined in the Revenue Act of 1918, and the corporation will not be required to compute its tax upon the profits arising therefrom in accordance with section 301(c) of that Act.

6

12-20-799: O. D. 415

The income of affiliated corporations which is derived from Government contracts is taxable (except as provided in sec. 240(a) of the Revenue Act of 1918) upon the basis of the total sum received from that source by the group and not upon the basis of the separate amount received by each corporation.

7



22-20-979: O. D. 532.

In 1919 a corporation derived a profit in excess of \$10,000 from Government contracts, but sustained a net loss on other operations. Held, that it may deduct the amount of such loss in ascertaining its net income subject to tax. If the amount of the excess profits credit exceeds the company's total net income from all sources for 1919 no tax will be imposed upon the portion of its net income for that year which was derived from Government contracts.

Since the company's net income included an item of net profit from Government contracts in excess of \$10,000, it will be required to supply fully all of the data called for by the supporting schedules of Form 1120-S.

8

38-20-1200: O. D. 662.

A subcontract entered into subsequent to November 11, 1918, based on a principal contract to furnish a product for the benefit of the United States, entered into between April 6, 1917, and November 11, 1918, both dates inclusive, constitutes a Government contract within the definition of section 1 of the Revenue Act of 1918, but the tax liability under section 301(c) of the Act attaches only where such subcontract was made between April 6, 1917, and November 11, 1918.

9

42-21-1867: O. D. 1063,

Income arising from a contract entered into subsequent to November 11, 1918, which is supplementary to an original contract entered into with the Government between April 6, 1917, and November 11, 1918, is taxable under section 301 (c) of the Revenue Act of 1918.

10

I('22)—2-16: Sol. Op. 128.

**WAR EXCESS PROFITS TAX—SECTIONS 1 AND 301(c), REVENUE ACT OF 1918—  
GOVERNMENT CONTRACTS**

Supplemental contracts made with a department of the United States Government after November 11, 1918, modifying original contracts entered into between April 6, 1917, and November 11, 1918, between the same parties, are "Government contracts" entered into between April 6, 1917, and November 11, 1918, within the meaning of the Revenue Act of 1918 and the income therefrom is taxable under section 301(c) of the above Act.

Reference is made to the proposed letter to the internal-revenue agent in charge, which raises the question whether the income from certain contracts between the M Company and the United States affecting original contracts entered into June —, 1918, between the same parties, is income from "Government contracts" entered into between April 6, 1917, and November 11, 1918, within the meaning of the Revenue Act of 1918 and taxable under section 301 (c) of that Act.

Section 1 of the Revenue Act of 1918 reads in part as follows:

The term "Government contract" means (a) a contract made with the United States, or with any department, bureau, officer, commission, board, or agency, under the United States and acting in its behalf, or with any agency controlled by any of the above if the contract is for the benefit of the United States, \* \* \*.

Section 301(c) of the above Act provides in part as follows:

For the taxable year 1919 and each taxable year thereafter there shall be levied, collected, and paid upon the net income of every corporation which derives in such a year a net income of more than \$10,000 from any Government contract or contracts made between April 6, 1917 and November 11, 1918, both dates inclusive, a tax equal to the sum of the following: \* \* \*

The facts are as follows: In January, 1918, a department of the United States Government entered into a contract jointly with the O Company and the P Company for the construction of certain vessels at an agreed price of 40x dollars. At the same time another contract was entered into with the above-named companies for the construction of a certain number of vessels of another type at an agreed price of 153x dollars. Subsequently, the O Company and the P Company were merged and the name changed to the M Company.

The original contracts contained a provision that the Government reserved the right to make changes in the minor details of the plans or specifications, and such changes would not invalidate the contract; the amount to be added or deducted from the contract price by reason of such changes to be agreed upon in writing by the contractor or contractors and the officer in charge, who was also the responsible officer for directing such changes. Many minor changes were made in the specifications by the officer in charge, and those under his direction, but no formal contract was ever executed covering such items. Certain contracts were entered into, however, which were formally executed on behalf of the Government. The first of those contracts, dated December —, 1919, involving  $\frac{1}{2}x$  dollars, related to the construction and equipment of the first-mentioned vessels and provided for an additional lavatory, windlass chain, locker, chain stoppers, blinds for officers' quarters, screens for air ports, extension of frame No. 34 athwartships, booby hatch, entrance, omission of syphons, changing whistle, difference in steel, difference in furniture, and additional drafting due to boiler change. The second contract, dated May —, 1920, involving 2-5x dollars, provided for additional skags, filler pieces, under decking, and additional riveting on these vessels. The third contract, dated March —, 1920, involving  $12\frac{1}{2}x$  dollars, related to the construction and equipment of the stated number of the other type of vessels. Many changes were made in the specifications, both as to these vessels and the machinery and equipment. Some items originally specified were omitted entirely. Additional machinery and furniture and equipment were added, and, in some instances, changes were made to secure a better quality of material and equipment. The fourth contract, dated March —, 1920, involving 6x dollars, provided for many changes in the construction and material for these vessels.

Parties to an unperformed contract may by mutual consent modify it by altering or adding provisions, provided the modifications do not make it illegal or violative of public policy. Whether such alterations constitute a new contract, thus doing away with the obligations of the former contract, or are merely supplementary thereto, depends upon the nature of the later agreements and the intentions of the contracting parties. *Nourse v. United States* (25 Ct. Cls., 7); *Mensfee v. Rankins* (Ky., 164 S. W., 365); *Uhlig v. Barnum* (Neb., 61 N. W., 749); *Pulpwood Company v. Perry* (Mich., 122 N. W., 552).

One written contract complete in itself will supersede another one made prior thereto in relation to the same subject matter. It is contended by the taxpayer that the subsequent contracts in the instant case are complete in themselves. They provide chiefly, however, for changes and additions that go toward the completion of the construction and equipment covered by the



original contracts, which in itself makes them dependent upon those contracts. The contracts of December —, 1919, and March —, 1920, provide that the "payment of the amount stipulated herein for each vessel shall be made on a percentage basis *in accordance with the terms of the original contract.*" The subsequent contracts have entirely omitted certain essential obligations imposed on those who enter into contracts with the Government which are clearly set forth in the original contracts, such as sufficient insurance on work as completed; liability of contractor for all damages that may occur during the course of construction; necessary police protection; suspension of 8-hour law; nonviolation of child-labor law; prohibition against employment of convict labor; protection of United States against patent infringement; forfeiture in case satisfactory progress is not made on the work; and non-assignability of contract. That the later agreements are not complete in themselves is further evidenced by the fact that there is no express cancellation of the original contracts. On the contrary, each of the subsequent contracts contains the following provision:

And, whereas, it is found advantageous and in the best interests of the service of the United States to modify the provisions of said contract as specified below; now, therefore, It is hereby agreed \* \* \* that the provisions of the original contract dated June —, 1918, *shall be changed in the following particulars, and in these respects only* \* \* \*.

The above provision, together with the fact that the directors of the corporation in the resolutions ratifying the subsequent contracts referred to and accepted them as supplementary contracts is indicative of the intention of the parties.

The department, with the approval of this office, has already ruled upon a similar question in the case of the R Company (O. D. 295, C. B. 1, p. 12 [Ruling No. 2 of this series.]). This company, on September —, 1917, entered into a contract with the commanding officer for the handling of certain supplies. In July, 1918, a supplementary agreement was entered into changing the basis of computation of profit. In March, 1919, a second supplementary contract was made which materially changed certain provisions of the original contract. The taxpayer contended, as in the instant case, that the second supplementary contract constituted a new contract, the income from which was not taxable under section 301(c) of the Revenue Act of 1918. That contention was answered in the following language:

This office holds that the agreement entered into in March, 1919, is in effect the same contract as that entered into in September, 1917, since the contract as of the latter date has never been revoked and supplanted by a new contract, but has only been modified by amending some of its provisions. Therefore, the income derived from the contract as of September —, 1917, as amended in July, 1918, and further amended in March, 1919, should be computed in accordance with the provisions of subdivision (c) of section 301.

In view of the foregoing, this office is of the opinion that the subsequent contracts between the United States Government and the M Company are supplementary to those of June —, 1918, and that the income therefrom is income from "Government contracts" entered into between April 6, 1917, and November 11, 1918, as defined by section 1 of the Revenue Act of 1918 and therefore taxable under section 301(c) of the above Act.

CARL A. MAPES,  
Solicitor of Internal Revenue.





Law Section 301.—Imposition of Tax (1918 Act—¶510, ante): (1921 Act—¶1011, post).

Article 715.—Allocation of New Income to Particular Source (Reg. 45—¶607, ante): (Reg. 62—¶1138, post).

26-19-597: A. R. M. 1.

If exact determination of income arising from Government contracts distinctively from other income is impossible, an approximation based on the proportion which sales to the Government bears to other sales should be used only in case approximations based on the respective cost and selling price are inapplicable. The approximation should be based upon the allocation of costs and allocation of selling price, in the most accurate manner possible from available records.

Amortization is not to be charged exclusively against income from Government contracts, and selling and administrative expenses not applicable to the Government contracts should not be so charged.

Representatives of the M Company state that it is impossible to ascertain profits from Government orders separately from profits on civilian orders, and ask:

(a) What method of apportionment of these profits is to be used in submitting a return for fiscal year ending June 30, 1919?

(b) What disposition is to be made of an amount claimed for amortization?

The answer to the first is that when profits can not be definitely allocated as to a Government contract, the proportion which the sales from the Government contract bears to the total sales is the proportion of income which is deemed to have arisen from the Government contract.

This answer presents a fair approximation under the following circumstances:

(a) If all articles made are of the same size, or grade, or if not, if the proportion sold to civilian trade of each kind is the same as the proportion sold to the Government.

(b) If the articles on hand at the beginning of the year cost the same as those manufactured during the year, or if the same proportion were sold out of those on hand at the beginning to civilians as were sold to the Government, or if all orders were filled exclusively either out of the ones on hand at the beginning or out of the ones manufactured during the year.

(c) If the prices charged the Government are identical with the prices charged the civilian trade.

The presence of all of these elements is so improbable that the Committee deems that the method proposed should be utilized only in case other methods likely to afford a closer approximation are inapplicable.

There is a probability that the inquiry was prompted by the fact that it is impossible to determine the exact cost of lots of articles made on Government contracts as distinguished from the exact cost of lots of articles made for civilian trade. Records may be available to an extent which will enable an approximation of the unit costs and selling prices from which an allocation may be determined. By working from the costs standpoint a method of closer approximation may be found.

In taking inventories of the stock on hand there should have been some method of ascertaining the unit price of articles that is reasonably accurate. This would apply as to articles of different kinds and grades, as well as to a condition in which the articles were all of the same kind and grade.

It is likely that articles made during the year were not made at the same costs as those on hand at the beginning. Accordingly, the first step would be to ascertain which of the articles on hand at the beginning were sold to the Government and which to civilian trade. If not otherwise accurately ascertainable, it is suggested that this be determined by assuming that the

first articles delivered during the fiscal year were delivered out of inventory, by taking the dates of delivery, respectively, to the Government and to the civilian trade, and apportioning these articles accordingly, having in mind, of course, the different grades and sizes. The selling price of these articles would be offset by the value at which inventoried, so that the profit could be determined.

If the records are as incomplete as the letter of inquiry indicates, it is hardly likely that the costs of finishing the articles in process of manufacture at the beginning of the year can be determined separately from the costs of articles which were placed in manufacture and completed during the year. Nevertheless, the ordinary manufacturing and trading statement usually gives the costs of goods completed during the year. Inasmuch as it is essential that these costs be allocated, if the proper inventory is made as to grades and sizes it is likely that the records will contain sufficient information to show the total manufacturing costs of each kind and grade of articles completed during the year. The value of the articles sold, as to kind and grade, is then easily ascertainable by deducting the closing inventory. The proportion sold to the Government to the total sold, as to each kind, affords basis for determining the costs of each kind sold to the Government. These costs, deducted from the selling price of each kind, would give the gross profit on Government contracts as to articles manufactured during the year, which, added to the gross profit from those delivered out of opening inventory should give the total gross profit.

Assuming other expenses can not be properly apportioned as to each source of income, then the proportion which the gross income from the Government contracts bears to the gross income from other sources determines the basis of apportionment.

In answering the second query, it is believed that the taxpayer's representatives should be informed that amortization is not exclusively chargeable against the profits made on the Government contract, and that part of this amortization is probably applicable to the fiscal year ending June 30, 1918. As to selling and administrative expenses, it should be borne in mind that part of these may be exclusively applicable to articles sold to civilian trade—as, for example, costs of selling organization and of advertising, which are not ordinarily essential to the procurement of Government contracts.

1

5-20-721: O. D. 394.

Procurement orders issued after November 11, 1918, in confirmation of informal orders entered into prior to November 12, 1918, are Government contracts made between April 6, 1917, and November 11, 1918, within the meaning of the Revenue Act of 1918 and whether fulfilled in 1918 or 1919 will be taxed at rates applicable to Government contracts.

In so far as stock purchased for Government contracts is used or useful for commercial purposes no separate inventory thereof need be made for Government contract accounting, such inventories being treated as commercial inventories in the ordinary course at the close of the taxable year 1919. If, however, a portion of such goods purchased is useful only for Government contracts and is still on hand at the close of the taxable year 1919, such goods should be inventoried at the then value if lower than cost and assigned to the Government contract section of the income statement for that year.

Advertising and sales promotion are not a part of the necessary expenses



of Government contracts, except as relating to such contracts, and are not proper deductions from the gross income derived from Government sales.

Such expenditures, if entered into on a large scale at a time when the Government was doing practically no commercial business, may be treated either as an expense of the year in which incurred and deducted from the commercial income only, or they may be treated as deferred items in the balance sheet and set up as good will thereon, being in the nature of expenditures for the building up of future business and not for the business secured during the taxable year in which such expenditures were incurred.

2





**Law Section 301.—Imposition of Tax (1918 Act—¶1010, ante): —(1921 Act.—¶1011, post).**

**Article 719.—Illustration of Computation Where Net Income Derived From Government Contract (Reg. 45—¶626, ante): (Reg. 62—¶1144, post).**

20-19-517: O. D. 281.

Method of computing the war profits and excess profits taxes in the case of a corporation which has income during a fiscal year ended in 1919 in excess of \$10,000 from Government contracts made between April 6, 1917, and November 11, 1918.

(1) The tax for the full fiscal year shall first be computed at the 1918 rates as if the fiscal year were the calendar year 1918. The same proportion of the tax so computed, which the income derived from Government contracts is of the total income from all sources, represents the tax due on the income from the Government contracts

(2) To compute the tax at the 1918 rates on the net income derived from sources other than Government contracts, the tax attributable to Government contracts is first deducted from the total tax computed at the 1918 rates, and the difference is reduced to the proportionate part thereof that the number of months of the fiscal year falling within 1918 is of the full fiscal year.

(3) The tax must then be computed on the entire income from all sources for the full fiscal year at the 1919 rates. The same proportionate part of this tax is taken as the net income from sources other than Government contracts is of the total net income. This amount is then reduced to the same proportionate part thereof that the number of months of the fiscal year falling within 1919 is of the full fiscal year.

The sum of the results obtained in following the procedure outlined in the three preceding paragraphs will be the total tax.

For example: Assume a corporation having a total net income of \$120,000 for the full fiscal year ended March 31, 1919, \$48,000 of which was derived from Government contracts. Assume further that the total war profits and excess profits tax computed at the 1918 rates is \$60,000, and the total war profits and excess profits at the 1919 rates is \$30,000.

The tax attributable to Government contracts would be two-fifths of \$60,000, or \$24,000. Deducting this amount from \$60,000 leaves \$36,000. The tax on the remaining net income at 1918 rates would be three-fourths of \$36,000, or \$27,000.

Applying the 1919 rates to the income not attributable to Government contracts would result in a tax of three-fifths of \$30,000, or \$18,000; but since only three months of the return period falls within 1919, the tax would be one-fourth of \$18,000, or \$4,500. The total war profits and excess profits tax would, therefore, be the sum of \$24,000, \$27,000, and \$4,500, or \$55,500.

The computation necessary to arrive at this result should be shown in a supplementary statement attached to the return. These computations will not apply to the income tax, which will be computed on the entire net income, as provided in section 205(b) of the Act. In the illustration given, the amount of war profits and excess profits tax to be credited against net income, in computing the income tax at both the 12 per cent and 10 per cent rates, would be \$55,500, as computed above.





**Law Section 302.—Limitation of Tax (1918 Act—¶523, ante): (1921 Act—¶1019, post).**

**Article 731.—Limitation of Tax (Reg. 45—¶639, ante): (Reg. 62—¶1158, post).**

1-19-115: O. D. 80.

The tax limitation prescribed in section 302, Revenue Act of 1918, is applied to the consolidated net income and may not be construed to apply separately to the net income of each unit included in the return.

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**Law Section 302.—Limitation of Tax (1918 Act—¶523, ante): (1921 Act—¶1019, post).**

**Article 732.—Limitation of Tax where return for fractional part of year (Reg. 45—¶643, ante): (Reg. 62—¶1161, post).**

I ('22)—36-493: I. T. 1439

### Revenue Act of 1921

A taxpayer made a return for seven months under the Revenue Act of 1921, which disclosed an actual net income of less than \$25,000. The question was submitted as to the proper method of computing the income and excess profits taxes of the taxpayer when section 302 of that Act is applied in determining the excess-profits tax.

Held, that in order for a corporation whose return covers a period of less than one year to have the full benefit of section 302, which allows an exemption of \$3,000 in all cases irrespective of whether the return is for an entire year or only for a fractional part of a year, it is necessary to compute the excess-profits tax upon the actual amount of the income shown by the return, less \$3,000. In computing the income tax, however, the credit of \$2,000 must be reduced to such a proportion of the full credit as the number of months in the period for which the return is made bears to 12 months. This amount should be added to the amount of the excess-profits tax and the sum deducted from the net income shown by the return. The net income should then be placed on an annual basis and the income tax computed. The income tax should then be reduced to the basis of the period covered by the return and, when added to the excess-profits tax, will give the total tax liability of the corporation.

Held also, that although the taxpayer's net income when raised to an annual basis exceeded \$25,000, that fact did not destroy its right to the proportionate part of the \$2,000 credit in computing the income tax, as the right to such credit is determined by the actual amount of the net income shown by the return and not by the amount which is disclosed when the net income is placed on an annual basis.

Applying this method of computation to a fictitious case will give the following results:

Net income (without deduction for credits).....	\$19,190.51
Exemption.....	3,000.00
Amount subject to excess-profits tax.....	\$16,190.51
Excess-profits tax at 20 per cent. (under sec. 302).....	3,238.10
Net income.....	\$19,190.51
Profits tax.....	\$3,238.10
Proportionate part of \$2,000.....	1,116.67
	<hr/> 4,354.77
Balance subject to income tax.....	\$14,835.74
Balance raised to annual basis.....	\$25,432.70
Income tax on annual basis.....	2,543.27
Income tax reduced to basis of return.....	\$1,483.57
Add: Excess-profit tax.....	3,238.10
Total tax for the period.....	<hr/> <hr/> \$4,721.67





**Law Section 303.—Tax When Partly Personal Service Business (1918 Act—  
¶524, ante): (1921 Act—¶1020).**

**Article 741.—Apportionment of Invested Capital and Net Income (Reg.  
45—¶645, ante): (Reg. 62—¶1163, post).**

1-19-114: O. D. 79.

Section 303 of the law will apply in the case of partial personal-service corporations until the point is reached where the nonpersonal-service element becomes negligible, under which conditions such corporations would make returns as personal-service corporations, as set out in section 218 of the law.

1

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12-19-410: T. B. M. 50

Where a corporation doing a commission and brokerage business satisfies the requirements of a personal-service corporation, except that it in part employs capital, surplus, and borrowed funds to make large advances to customers and receives more interest than it pays as a result of such transactions, it should be assessed under section 303. The income from commissions and brokerage should be considered as arising from personal service, and the remainder of the income as derived from the use of capital.

2





**Law Section 304.—Exemptions** (1918 Act—¶525, ante): (1921 Act—¶1021 post).

**Article 752.—Net income exempt from tax** (Reg. 45—¶682, ante): (Reg. 62—¶1174, post).

II('23)-3-772: I. T. 1601.

**Revenue Acts of 1918 and 1921.**

Inquiry is made whether the value of the silver contained in the ore mined by the M Company, amounting to about 23 per cent in value, should be treated as the value of a by-product obtained as a result of the company's gold mining operations and therefore exempt from profits tax as a portion of the company's income derived from the mining of gold.

Held, that under section 304 of the Revenue Acts of 1918 and 1921, only the income derived from the gold itself was exempt from profits tax. This exemption has not been extended to income derived from other metals, although they may have represented nothing more than by-products incidental to gold mining. This construction was announced in articles 752 and 753 of Regulations 45 and 62, covering the Revenue Acts of 1918 and 1921, respectively. Article 753 assumes the case of a corporation engaged in mining both gold and other rare metals, and explains that in such case only the income attributable to the mining of gold is exempt from profits tax.

The income of corporations derived from gold mining was never exempt from income tax, but was only exempt from the war-profits or the excess-profits tax for the years 1917 to 1921, inclusive, or for fiscal years falling within those calendar years. As the profits tax ceased to be effective at January 1, 1922, income from gold mining is now taxed in the same way as income from other mining operations.





**Law Section 310.—Prewar Period (§529).**

**Article 771.—Prewar Period (§685).**

(See 39-21-1849; Section 331, Article 941.) When year 1913 was one of extraordinary depression.

**1**





**Law Section 311.—War Profits Credit (§530).****Article 781.—War Profits Credit (§686).**

5-19-264: T. B. R. 16.

Method of ascertaining a corporation's average net income and average invested capital for the prewar period where corporation closes its books on the basis of a fiscal year which differs from the calendar year.

The Income Tax Unit has requested a ruling as to the method by which a corporation is to ascertain the average net income and the average invested capital for the prewar period as called for in section 311 (2) in cases where a corporation closes its books on the basis of a fiscal year differing from the calendar year. The prewar period is defined in section 310 of the Revenue Act of 1918, which reads: "That as used in this title the terms 'prewar period' means the calendar years 1911, 1912, and 1913, or, if a corporation was not in existence during the whole of such period, then as many of such years during the whole of such period, then as many of such years during the whole of which the corporation was in existence." The problem presented by the inquiry of the Income Tax Unit is as to how the fiscal year periods are to be made to conform to the calendar years specified for the prewar period.

It is recommended that the computation be made as follows:

The starting point for each year is the beginning of the fiscal year ending in 1911, 1912, and 1913, respectively, and the invested capital should be ascertained as at those dates. To these sums should be added any contributions of capital between the beginning of each such fiscal year and January 1, 1911, 1912, and 1913, respectively, and corresponding deductions should be made in respect of any dividends and any refunds of capital during those respective periods. To these balances should be added a pro rata share of the earnings of the respective fiscal years, and the totals thus arrived at will be deemed to be the invested capital of the taxpayer at January 1, 1911, 1912, and 1913, respectively. Taxpayers should file with their returns copies of their balance sheets at the beginning of each fiscal year and a schedule for each year showing the adjustments made in computing the invested capital as at the beginning of each calendar year during the prewar period.

Where a taxpayer has such accounting records as will enable him to prepare an accurate balance sheet showing the true surplus and undivided profits at the beginning of each one of the prewar calendar years and an accurate income account for such years, he may make the computation upon this basis and explain the method used in such detail as will enable the Commissioner of Internal Revenue to determine whether such basis is proper.

Where a taxpayer has not been in business during the whole of the prewar period the above methods will be applicable to such full calendar years during the whole of which years the taxpayer was in business.

1

8-19-319: O. D. 184.

Corporations are not allowed at this late date to adjust salaries paid during the prewar period when such adjustment is made solely for the purpose of increasing the war profits credit for the taxable year.

2

32-20-1124: A. R. R. 221.

## REVENUE ACT OF 1917.

Recommended in the appeal of the M Company that the action of the Income Tax Unit fixing the deduction to be used in computing the tax at 7 per cent be affirmed.

The Committee has had under consideration the appeal of the M Company from the action of the Income Tax Unit fixing the deduction at 7 per cent. for the purpose of computing the excess profits tax instead of 8 per cent claimed by the corporation. A number of adjustments have been made by the Unit, all of which have been conceded by the corporation except the adjustment with respect to the percentage deduction.

This corporation was organized in July, 1915, under the laws of the State of New York, with an authorized capital stock of 5x dollars and succeeded a corporation known as the N Company.

It appears that prior to 1910, the corporation known as the N Company owned a frame mill building, some real estate, and some water power rights. The majority of the stock of this corporation was owned by one, A, and his brother, B, the latter owning 10 per cent of the stock. The corporation had outstanding two issues of bonds—first mortgage bonds in the sum of 4x dollars and second mortgage bonds in the sum of 6x dollars which were largely held by creditors of the corporation.

Sometime in June, 1914, the corporation became insolvent and stopped operations. Bankruptcy proceedings were instituted and in September, 1914, the corporation was declared by legal proceedings to be a bankrupt. Proceedings were started to foreclose the first mortgage. In March, 1915, a sale under the first mortgage was held at which time the property was acquired on behalf of the first mortgage bondholders at a price of 5x dollars, which represented the face of the first mortgage bonds and accrued interest. In June, 1915, steps were taken to form a new corporation and in July of that year the new corporation came into existence and took over the water power rights, real estate and buildings of the old corporation from the trustee. Stock of the new corporation was divided among the first mortgage bondholders in proportion to their ownership of bonds.

The newly organized corporation made extensive changes in the water power and in the machinery. The machinery which had been left at the plant in 1914, when the old corporation closed down was practically worthless. The new corporation installed at a considerable expense some new machinery and changed practically the entire system of production. New banking connections were formed and additional funds were acquired through these connections for the purpose of securing additional working capital.

The only points of similarity between the M Company and the N Company are that the *product manufactured is sold under the same trade name and is produced on the same location.*

The attorney for this corporation contends in a memorandum brief submitted that it would not be fair and equitable to say that the trade or business carried on by the new corporation was substantially a continuation of the trade or business carried on by the N Company and that the N Company had no good will to continue for the reason that it became bankrupt in 1914, and was closed for a period of approximately one year before the new corporation came into existence. The attorney submits that the Income Tax Unit was in error in fixing the deduction at 7 per cent for the purpose of computing the tax, rather than at 8 per cent claimed by the corporation, for the reason that the new corporation did not succeed to the trade or business of the N Company since it had become bankrupt and had not been in operation since the early part of 1914. In this connection it is contended that since the N Company



had not been operating for a period of over one year there was no trade or business in existence at the time the new corporation was organized for the purpose of acquiring the assets formerly owned by the N Company; therefore, since no business was in existence it was impossible for the business of the new corporation to be considered a continuation of the business of the bankrupt corporation.

Section 204 of the Revenue Act of 1917 deals with the percentage deduction allowed to corporations or partnerships not in existence during the whole of any one calendar year during the prewar period and provides in part as follows:

A trade or business carried on by a corporation, partnership, or individual, although formally organized or reorganized on or after January second, nineteen hundred and thirteen, which is substantially a continuation of a trade or business carried on prior to that date, shall, for the purposes of this title, be deemed to have been in existence prior to that date, and the net income and invested capital of its predecessor prior to that date shall be deemed to have been its net income and invested capital.

#### Article 22 of Regulations 41 reads as follows:

If a trade or business carried on by a corporation, partnership or individual was formally organized or reorganized on or after January 2, 1913, but is substantially a continuation of a trade or business carried on prior to that date, then the corporation or partnership shall be deemed to have been in existence, or the individual shall be deemed to have been engaged in the trade or business, prior to that date, and for the purpose of computing the deduction the net income and invested capital of the predecessor shall be deemed to have been the net income and invested capital of the present owner for the prewar period.

The Income Tax Unit has held in a specific case where an individual was engaged in the hardware business during the prewar period and made more than 9 per cent on his invested capital, but subsequent to the prewar period the hardware business was sold and the individual established a furniture store and made over 9 per cent on his invested capital in that business, that the deduction should be 8 per cent since he is now carrying on a business in which he was not engaged during the prewar period. The Unit has also held in the case of an individual buying a hotel business in 1914, which had been in existence during the prewar period that the deduction should be computed at 7 per cent, but since no records were available so that the average invested capital for that period could be ascertained a claim for final assessment under the provisions of section 210 and articles 18, 24 and 52 of Regulations 41 would be in order provided the Secretary of the Treasury is unable to satisfactorily determine the invested capital for the prewar period.

In the instant case, the M Company came into existence in 1915, after its predecessor, the N Company, had ceased to operate as a going concern and had not operated for a period of one year or more prior to the organization of the new company. However, it appears that this corporation acquired the assets of the bankrupt corporation and that even though a considerable amount was invested in new machinery, etc., the plant of the new corporation is located in the same place as the old corporation and that the product of the new corporation is sold under the *same trade name* as the product of the predecessor corporation was sold.

The facts presented in this case clearly indicate to the Committee that the business now carried on by the M Company is substantially a continuation of the trade or business carried on by its predecessor, the N Company, and that this view is substantiated by the fact that the new corporation is operating on the *same location* as its predecessor and the product of the new corporation is sold under the *same trade name*.

In view of the foregoing the Committee is clearly of the opinion that the action of the Income Tax Unit in holding that the new business is substantially a continuation of the trade or business carried on by the N Company is correct,

and, therefore, recommends that its action in fixing the deduction for the purpose of computing the tax at 7 per cent, rather than 8 per cent claimed by the corporation was proper.

3



**Law Section 311.—War Profits Credit (§530).****Article 783.—War Profits Credit Where no Prewar Period (§690).**

10-20-783: A. R. R. 36.

Held, that the median as determined under the provisions of paragraph (c) (2) of section 311 of the Revenue Act of 1918 is final and shall be used in computing the war profits credit of the M Company. Relief can not be granted under section 328 of the Act merely for the reason that the application of the median does not give the relief to which taxpayers think they are entitled.

The M Company claims that inequity and hardship are imposed upon it through the application of the "median" in determining its war profits credit under the Revenue Act of 1918 and requests the Commissioner to determine its tax liability under the provisions of section 328 for the reason that the median as determined allows the taxpayer a war profits credit of slightly in excess of 10 per cent.

It is contended that this percentage is not a representative percentage earned by corporations in the same general class of business during the prewar period. The taxpayer has made an independent investigation and apparently has taken into consideration only a few concerns similarly situated and claims that these concerns earned over 20 per cent during the prewar period. The Bureau has computed the median by using the returns of all corporations in same general class of business as that conducted by the M Company.

On account of this discrepancy the Commissioner is urged to ascertain and assess the tax in this case as provided in section 328 of the statute.

**Section 311(c) of the Revenue Act of 1918 provides in part:**

If the corporation was not in existence during the whole of at least one calendar year during the prewar period, then, except as provided in subdivision (d), the war profits credit shall be the sum of: (1) A specific exemption of \$3,000; and (2) an amount equal to the same percentage of the invested capital of the taxpayer for the taxable year as the average percentage of net income to invested capital for the prewar period, of corporations engaged in a trade or business of the same general class as that conducted by the taxpayer; but such amount shall in no case be less than 10 per centum of the invested capital of the taxpayer for the taxable year. Such average percentage shall be determined by the Commissioner on the basis of data contained in returns made under Title II of the Revenue Act of 1917, and the average known as the median shall be used.

Article 783 of Regulations 45 interpreting the above-quoted provision of law provides in part as follows:

If a corporation has no prewar period, then the war profits credit consists of the sum of the specific exemption of \$3,000 and an amount equal to the same percentage of the invested capital for the taxable year as the average percentage of net income to invested capital for the prewar period of corporations engaged in a trade or business of the same general class as that conducted by the taxpayer, but not be less than 10 per cent of its invested capital for the taxable year. The war profits credit shall be computed in the first instance on the basis of 10 per cent of the invested capital, and when the average percentage of corporations engaged in the same general class of trade or business has been determined the amount of the tax will if necessary be recomputed.

Section 327 of the Revenue Act of 1918 provides that in certain cases the tax shall be determined as provided in section 328. In the instant case it can not be said that the Commissioner is unable to determine the invested capital, that the taxpayer is a foreign corporation, that a mixed aggregate of tangibles and intangibles has been paid in for stock, etc., nor that the tax if determined without the benefit of this section would, owing to abnormal conditions affecting the capital or income of the corporation, work an exceptional hardship evidenced by a gross disproportion between the tax computed without the benefit of section 327 and the tax computed by reference to representative corporations as provided in section 328.

Section 327 does not apply to any case in which the tax is high merely

because the corporation earned within the taxable year a high rate of profit upon a normal invested capital.

After analyzing the situation presented in the instant case the Committee is of the opinion and recommends (1) that the median established as provided by law and published by the Bureau be considered final and that the taxpayer is not entitled to consideration under the provisions of section 328 of the statute; (2) that there is no warrant in law or the regulations which authorizes the Commissioner to allow a larger percentage in this class of cases than that established by the median for the purposes of computing the war profits credit; and (3) that the instant case does not fall within any class of cases enumerated in section 327, therefore, relief can not be granted under section 328.

1



**Law Section 312.—Excess Profits Credit (1918 Act—¶541, ante): (1921 Act §1025, post).**

**Article 791.—Excess Profits Credit (Reg. 45—¶724, ante): (Reg. 62—¶1177, post).**

20-21-1644: A. R. R. 499

# REVENUE ACT OF 1917.

Recommended in the case of the M Company that the action of the Income Tax Unit in limiting the deduction to 8 per cent. as provided in section 204 of the Revenue Act of 1917 be sustained.

The Committee has had under consideration the appeal of the M Company from the action of the Income Tax Unit in disallowing claim for percentage deduction under section 205 of the Revenue Act of 1917.

The M Company is a foreign corporation organized September —, 1914, and, accordingly, was not in existence during any of the prewar years determined by section 203 of the Revenue Act and article 6 of Regulations 41. The company, however, contends that the application of 8 per cent. on invested capital, in accordance with section 204 of the Revenue Act, works an undue hardship on the company since the Commissioner has determined a "median" rate in excess of 9 per cent. for representative companies engaged in the particular business of the corporation.

Section 204 of the Revenue Act reads, in part, as follows:

That if a corporation or partnership was not in existence, or an individual was not engaged in the trade or business, during the whole of any one calendar year during the prewar period, the deduction shall be an amount equal to eight per centum of the invested capital for the taxable year, plus in the case of a domestic corporation \$3,000 and in the case of a domestic partnership or a citizen or resident of the United States \$6,000.

Section 205 of the Revenue Act reads, in part, as follows:

(a) That if the Secretary of the Treasury, upon complaint finds either (1) that during the prewar period a domestic corporation or partnership, or a citizen or resident of the United States, had no net income from the trade or business, or (2) that during the prewar period the percentage, which the net income was of the invested capital, was low as compared with the percentage, which the net income during such period of representative corporations, partnerships, and individuals, engaged in a like or similar trade or business, was of their invested capital, then the deduction shall be the sum of \* \* \*.

In the instant case, the Committee has no discretion but must construe the law in accordance with its plain language. Section 204 expressly provides for a deductible rate when a corporation was *not in existence* during the whole of any one calendar year of the prewar period while section 205 recognizes the existence of the corporation during the prewar year but, under such existence, having no income or having income that was low compared with the percentage of income to invested capital of similar representative corporations. Furthermore it should be noted that section 205 is applicable only to a domestic corporation, partnership, or citizen.

In the instant case, it is admitted by the taxpayer that the M Company, a foreign corporation, was not in existence during the prewar years and accordingly this Committee recommends that the action of the Income Tax Unit in limiting the deduction to 8 per cent., as provided in section 204 of the Revenue Act, be sustained.

I ('22)—2-24: A. R. R. 716

# REVENUE ACT OF 1917

Recommended, in the appeal of the M Company that the action of the Income Tax Unit in determining the "average deduction" under section 205 of the Act of October 3, 1917, by averaging the deductions allowed to representative concerns after the limitations provided in section 203 of the Act had been applied, be affirmed and the appeal denied.

The Committee has considered the appeal of the M Company in which it is contended that the method employed in determining the "average deduction" under section 205 of the Act of October 3, 1917, is erroneous. As the question raised by the appeal is entirely a question of law involving the construction of the statute, the case was referred to the Solicitor, Bureau of Internal Revenue, for an opinion. The contention of the appellant and the fact upon which it is based are sufficiently set forth in the Solicitor's opinion and therefore are not here repeated. The Solicitor's opinion is as follows:

Consideration has been given to the attached file wherein it appears that the Income Tax Unit had disallowed the claim of the M Company for the use of 9 per centum, rather than 7 per centum, in computing the deduction allowed under section 205(a)2 of the Revenue Act of October 3, 1917. The question, upon which the opinion of this office has been requested, is whether or not the construction contended for by the appellant in its brief of August —, 1921, is correct.

Briefly, the facts may be stated as follows:

The M Company in preparing its corporation excess profits tax returns for the calendar year 1917 determined its excess profits deduction by the use of 7 per centum of its invested capital and entered the amount so determined upon its return. Claim for abatement was duly filed for the amount by which the tax shown to be due upon the return exceeded the amount determined by the use of 9 per centum of the invested capital. During the prewar period the operations of the company had been greatly curtailed, and, for a portion of the period, had entirely ceased. Objection has been made to the method used by the Income Tax Unit in determining the average deduction under section 205 of the Act in cases (1) where taxpayers had no net income during the prewar period and (2) where the percentage which the net income was of the invested capital was low as compared with the percentage which the net income during such period of representative concerns was of their invested capital. It is the contention of the taxpayer that in computing the average deduction under section 205 the limiting provisions of section 203 are not to be applied until there has been an ascertainment of the percentage which the average net income bears to the average invested capital of representative concerns.

The portions of the Act which are material to the decision of the question involved are as follows:

SEC. 201. That in addition to the taxes under existing law and under this Act there shall be levied, assessed, collected, and paid for each taxable year upon the income of every corporation, partnership, or individual, a tax (hereinafter in this title referred to as the tax) equal to the following percentages of the net income:

Twenty per centum of the amount of the net income in excess of the deduction (determined as hereinafter provided) and not in excess of 15 per centum of the invested capital for the taxable year; \* \* \*

SEC. 203. That for the purposes of this title the deduction shall be as follows, except as otherwise in this title provided—

(a) In the case of a domestic corporation, the sum of (1) an amount equal to the same percentage of the invested capital for the taxable year which the average amount of the annual net income of the trade or business during the prewar period was of the invested capital for the prewar period (but not less than 7 or more than 9 per centum of the invested capital for the taxable year), and (2) \$3,000; \* \* \*

SEC. 205. (a) That if the Secretary of the Treasury, upon complaint, finds either (1) that during the prewar period a domestic corporation or partnership, or a citizen or resident of the United States, had no net income from the trade or business, or (2) that during the prewar period the percentage, which the net income was of the invested capital, was low as compared with the percentage, which the net income during such period of representative corporations, partnerships, and individuals, engaged in a like or similar trade or business, was of their invested capital, then the deduction shall be the sum of (1) an amount equal to the same percentage of its invested capital for the taxable year which the average deduction (determined in the same manner as provided in section 203, without including the \$3,000 or \$6,000 therein referred to) for such year of representative corporations, partnerships, or individuals, engaged in a like or similar trade or business, is of their average invested capital for such year plus (2) in the case of a domestic corporation \$3,000, and in the case of a domestic partnership or a citizen or resident of the United States \$6,000 \* \* \*

The taxpayer contends that the following is the correct method of determining the average deduction to be allowed in those cases which are governed by the provisions of section 205:

(1) Determine the percentage which the average amount of the annual net income was of the invested capital for the prewar period of representative corporations.



(2) Apply the limitation imposed by section 203, to wit, "not less than 7 or more than 9 per centum."

(3) Apply such percentage to the statutory invested capital of the corporation whose tax is being computed.

(4) Add to the resultant product the specific exemption of \$3,000.

It will be observed that in the above method no consideration or effect is given to the limitations prescribed in section 203 until there has been a determination of the percentage which the net income bears to invested capital. In so computing the deduction, the fact is completely overlooked that there is, in a great number of cases, a noticeable disparity between the percentage of deduction allowed and the percentage between net income and invested capital.

The following example, in which it is assumed that the corporations are properly comparable for the purpose of determining the deduction to be allowed to the fourth company, will illustrate the contention of the taxpayer:

Name of company	Average invested capital for prewar period	Average taxable income for the prewar period	Percentage of earnings	Percentage of deduction
A.....	\$3,000,000	\$450,000	15	9
B.....	2,500,000	225,000	9	9
C.....	3,500,000	210,000	6	7
Total.....	\$9,000,000	\$885,000	9½	
Average.....	3,000,000	295,000	9½	

In the foregoing example the percentage of average earnings to invested capital is 9½ per cent. The taxpayer asserts that the limitation fixed by section 203 should be applied to this percentage and no consideration be given to the actual deduction permitted to Companies A, B, and C, as shown in the column designated "Percentage of deduction."

With the contention of the taxpayer this office can not agree. Section 205 is a relief provision for those taxpayers who had no net income during the prewar period, or whose net income during the said period was low as compared with that received by representative concerns engaged in like or similar trades or business. Many taxpayers are thus permitted to take greater deductions from their net income for the purpose of computing their war excess profits tax than would otherwise have been allowed. In some cases, if normal conditions had prevailed during the prewar period, the earnings of the corporations would probably have been large enough to entitle them to the maximum deductions provided in section 203. In others, the earnings would probably have been so low that the corporations could only have taken the minimum deduction therein provided. What they might have earned, however, is a matter of speculation. To equalize the burden of the tax, and to prevent any discrimination in favor of those taxpayers engaged in similar trades or businesses who had a profitable prewar history, Congress enacted that in those cases covered by section 205 the deduction should be the sum of (1) "an amount equal to the same percentage of its invested capital for the taxable year which the average deduction \* \* \* for such year of representative corporations, partnerships or individuals, engaged in a like or similar trade or business, is of their average invested capital, for such year, plus (2) in the case of a domestic corporation \$3,000 \* \* \*."

It must be observed that the term "average deduction" is used. There is nothing in section 205 which would justify the interpretation that the term means average percentage. Such is the construction placed upon the term by the present taxpayer when it contends that the limitation of section 203 should not be imposed in computing the deduction allowed under section 205 until after there has been a determination of the percentage which the average prewar net income of representative concerns is of their average prewar invested capital. The deduction allowed to some corporations in excess of the specific exemption is an amount equal to the same percentage of the invested capital for the taxable year which the average amount of the annual net income, during the prewar period, was of the invested capital for the same period, but it does not follow that that amount is allowed in all cases. In many cases the deductions bear only a slight relation to the percentage of prewar net income to prewar invested capital. If the earnings of a corporation during the prewar period greatly exceeded 9 per cent of its invested capital, that fact will not assist it any in getting a greater deduction than the maximum provided in the Act. It is only permitted to take a deduction of 9 per cent plus the specific deduction for the purpose of computing the war excess profits tax. If, on the other hand, the corporation's earnings were less than 7 per cent during the prewar period, it is entitled to a deduction of 7 per cent.

The ascertainment of the percentage of income to capital is the starting point in the determination of the deduction, but in those cases where the income of the taxpayer is greater than 9 per cent or less than 7 per cent, the actual amount of the deduction can never be determined until there has been an application of the limitations imposed by section 203. This is a very essential and necessary step. The deduction is the amount finally allowed in the computation of the tax and may be independent of the percentage which the income of the taxpayer bears to its invested capital. The actual amounts which representative concerns engaged in similar trades or businesses are permitted to deduct from their income constitutes the basis for the computation of the deduction allowed to those taxpayers whose cases are covered by section 205 of the Act. Full force and effect must be given in every instance to the limitations of section 203.

It is therefore the opinion of this office that the construction placed upon section 205 by the taxpayer is erroneous, and further that the term "average deduction," as used in said section, means the average of the deductions allowed to representative concerns after the limitations provided in section 203 have been applied.

The Committee finds itself entirely in accord with the opinion of the Solicitor, and, therefore, recommends, in the appeal of the M Company that the action of the Income Tax Unit in determining the "average deduction" under section 205 of the Act of October 3, 1917, by averaging the deductions allowed to representative concerns after the limitations provided in section 203 of the Act have been applied, be affirmed and the appeal denied.

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I (22)-27-393: I. T. 1385

### Revenue Acts of 1917 and 1918.

The question is presented as to whether the amount of the net incomes disclosed by the returns of a corporation for the prewar period, and upon which the taxes have been actually assessed and paid, should be accepted as correct in determining the average net income for the prewar period for use in computing the profits tax credit under the Revenue Acts of 1917 and 1918, or whether this average should be based on the correct amount of the income for each year of the prewar period, irrespective of the amount of the income shown by the return for such year.

Held, that both section 203(a) of the Revenue Act of 1917 as interpreted by article 29 of Regulations 41, and section 311(a)2 of the Revenue Act of 1918 as interpreted by article 781 of Regulations 45, contemplate that the average net income for the prewar period, when used for the purpose of the deductions provided for in these sections, shall be the correct average net income for such period, and that they do not contemplate that the net incomes shown by the returns for the prewar period shall be accepted in determining the average net income for such period in the event that the amount of the net incomes shown by such returns are found to be incorrect.

Where errors are found in the amount of the net income shown by a return for any year of the prewar period, such errors should be corrected before the amount of the average net income for the prewar period is determined, both with reference to the Revenue Act of 1917 and the Revenue Act of 1918.

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(See A. R. R. 2564; Sec. 326, Art. 835 [ruling number 4]. Adjustment of compensation paid officers during the prewar years for the purpose of adjusting war-profits credit for the year 1918.

4





**Law Section 320.—Net Income** (1918 Act—¶543, ante): (1921 Act—¶1027, post).

**Article 801.—Net Income** (Reg. 45—¶725, ante): (Reg. 62, ¶1178, post).

8-19-335: T. B. M. 42.

With respect to the inquiry whether or not value appreciation of property taken up on the books of the taxpayer and returned as a part of his taxable income for the year in which the appreciation was written up may be included as a part of the income for the prewar period, a negative reply must be given. Appreciation is not and has not been at any time under the income tax laws proper taxable income, and where such appreciation has been taken up on the books of the taxpayer the item must be excluded in computing income, even though an income tax has been paid upon it.

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**Law Section 320.—Net Income (§543).****Article 802.—Prewar net income of affiliated corporations (§734).**

12-21-1526: A. R. M. 116.

Articles 802 and 869 of Regulations 45 provide for the inclusion of the same corporate entities in prewar years for determining average consolidated prewar net income and invested capital that may properly be consolidated in the taxable years 1917 or 1918.

Consideration has been given to the request made by the Income Tax Unit for a ruling which would construe articles 802 and 869 of Regulations 45 for the guidance of the Unit.

Section 330 of the Revenue Act of 1918 reads as follows:

Any asset of the trade or business in existence both during the taxable year and any prewar year is included in the invested capital for the taxable year but is not included in the invested capital for such prewar year, or is valued on a different basis in computing the invested capital for the taxable year and such prewar year, respectively, then under rules and regulations to be prescribed by the Commissioner with the approval of the Secretary *such readjustments shall be made as are necessary to place the computation of the invested capital for such prewar year on the basis employed in determining the invested capital for the taxable year.*

Article 869 of Regulations 45 provides:

*The invested capital of affiliated corporations for the prewar period shall be computed on the same basis as the invested capital for the taxable year, except that where any one or more of the corporations included in the consolidation for the taxable year were in existence during the prewar period, but were not then affiliated as herein defined, then the average consolidated invested capital for the prewar period shall be the average invested capital of the corporations which were affiliated in the prewar period plus the aggregate of the average invested capital for each of the several corporations which were not affiliated during the prewar period. Full recognition, however, must be given to the provisions of section 330 of the Statute, particularly the last paragraph thereof, and of articles 931-934.*

Manifestly if the invested capital of affiliated corporations is to be computed for the prewar period on the same basis as invested capital is computed for the taxable year, there can be no greater number of corporate units consolidated in the prewar years than were entitled to consolidation in the taxable year. It is also noted that consolidation of similar corporate units is determined by the inclusion in the prewar period of the aggregate of the average invested capital for each of the several corporations not affiliated during the prewar period but affiliated during the taxable year. This further provision only emphasizes the intent of the regulation to determine affiliation of the prewar years by the affiliation of the taxable years.

Article 802 of Regulations 45 reads:

The consolidated net income of affiliated corporations for the prewar period shall be the average consolidated net income for the prewar years of such of the several corporations included in the consolidation for the taxable year as were affiliated during the prewar period, plus the aggregate of the average net income for each of the corporations not affiliated during the prewar period which were in existence during all of the prewar period or during at least one full year within the prewar period. The net income of a subsidiary corporation organized during the prewar period by an existing corporation shall also be included.

This article determining the basis of consolidated prewar net income is, in effect, the same in principle as article 869 above quoted, which determines consolidated invested capital for the prewar period. The expression "such of the several corporations included in the consolidation for the taxable year as were affiliated during the prewar period" identifies the affiliated corporations of the prewar period and clearly determines that the corporate entities of the consolidated unit for each of the prewar years are those corporate entities affiliated in the taxable year. This is only emphasized by the further provision for inclusion of the aggregate of the average net income of such corpo-

rations not affiliated during the prewar period but affiliated during the taxable year, thereby clearly determining, as above stated, that the consolidated unit of the prewar year must be composed of the same corporate units as are included in the consolidated unit of the taxable year. If this condition did not prevail, there would be no reason for disallowing any of the corporate units affiliated during the prewar years but operative as separate or otherwise affiliated units during the taxable years 1917 or 1918 from claiming the same consolidated condition for the prewar years to determine excess and war profits credits of each company or each group of companies properly affiliated during the taxable years.

The Committee is accordingly of the opinion that there can be taken into consideration in the prewar years only such corporate units for the purpose of determining average prewar income and average prewar invested capital as may be properly consolidated into one corporate unit for the taxable year 1917 or 1918.



Law Section 325.—Terms Relating to Invested Capital (1918 Act—¶548, ante): (1921 Act—¶1028, post).

Article 811.—Intangible and Tangible Property (Reg. 45—¶738, ante): (Reg. 62—¶1179, post).

33-20-1140: O. D. 635.

A corporation acquired a contract and leasehold, paying therefor with an issue of stock in the sum of 500x dollars. There was no definite division or assignment of the amount paid between the contract and leasehold. At the time of acquiring these rights the amount paid was charged off against surplus; it is now sought to restore this sum to surplus and a ruling is desired whether the contract and leasehold are to be treated as tangible or intangible property.

Held, that an unperformed contract to furnish manufactured products represents no rights in tangible property which would entitle it to be regarded as deriving its value chiefly therefrom. On the contrary, the value of the contract is of an intangible nature, contingent upon the performance of its terms and the realization of the anticipated profit. The intangible rights under such a contract would, therefore, be subject to the limitation contained in section 207 of the Revenue Act of 1917, and section 326 of the Revenue Act of 1918, in the case of intangible property purchased with corporate stock. On the other hand a leasehold is tangible property, and may be included in invested capital, under either the 1917 or 1918 Act, at its actual cash value when paid in for stock, such value in no case to exceed the par value of the stock paid therefor, subject to qualifications not relevant in this case.

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(See 47-21-1937: sec. 326, art. 840.) Circulation structure of a newspaper.

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**Law Section 325.—Terms Relating to Invested Capital (1918 Act—¶548 ante): (1921 Act—¶1028, post).**

**Article 812.—Borrowed Capital: Securities (Reg. 45—¶739, ante): (Reg. 62—¶1180, post).**

27-19-609: S. 1200.

Preferred stock, if in the records of the corporation it is declared to be part of its capital stock, though convertible into first-mortgage bonds of even date therewith, is inferior, on a distribution of assets to pay debts, to the rights of general creditors, and is to be treated as invested capital so long as it is not converted.

Opinion is requested as to the status of stock designated as "first preferred stock" under the following sections of the Revenue Act of 1918.

Section 325 (a) provides:

The term "borrowed capital" means money or other property borrowed, whether represented by bonds, notes, open accounts, or otherwise.

Section 326 (b) provides:

As used in this title, the term "invested capital" does not include borrowed capital.

The following facts are presented: The M Company, a corporation by an amendment to its articles of incorporation and pursuant to a resolution of its stockholders duly adopted, increased the amount of its capital stock from 18x dollars to the sum of 45x dollars, of which y shares were to be preferred. Certificates of "first preferred stock" were issued, which contained a provision that the shares of stock should be convertible at the election of the holder into first mortgage gold bonds. At the time the preferred stock was issued, the directors provided for an issue of coupon bonds, secured by a first mortgage or trust deed. Said bonds and trust deed were of even date with said certificates of preferred stock. The trust deed was executed, delivered to the trustee and placed on record. It contains the provision that "said bonds shall be held by said trustee and its successors until issued and shall be issued and used only for the purpose of being exchanged, par for par, for shares of preferred stock."

The specific question is:

Is first preferred stock which, at the election of the holder, is convertible into bonds, of even date therewith and secured by a first mortgage trust deed—such bonds to be issued only for the purpose of converting such preferred stock—to be treated as invested capital or as borrowed capital?

The rights of holders of preferred stock which represents a part of the capital stock of a corporation, and is secured by a trust deed or otherwise, are inferior to the rights of general creditors. (*Westerfield-Bonte v. Burnett*, Ky., 195 S. W. 479; *Miller, executor, v. Batterman, treasurer*, 47 Ohio St. 141, 24 N. E. 146; *Booth v. Union Fiber Co.*, Minn., 162 N. W. 677; same case on rehearing, 171 N. W. 307; *Spencer v. Smith et al.*, 201 Fed. 674; *Armstrong v. Union Trust & Savings Bank*, 248 Fed. 269.) Whether persons who contribute or make payments to a corporation are stockholders or creditors of the company is a question to be determined by the intention of the parties as disclosed by the circumstances. (*Miller, executor, v. Batterman, treasurer*, 47 Ohio St. 141, 24 N. E. 496.) Persons who negotiate for and acquire preferred stock "designed as," and "declared to be," a part of the capital stock of a corporation are held to full knowledge of the character of their investments. From such facts it is conclusively presumed that the parties intend such persons to be stockholders—preferred stockholders—and not creditors (*Armstrong v. Union Trust & Savings Bank*, 248 Fed. 268).

In the case of *Spencer v. Smith et al.*, 201 Fed. 647, the court held that the rights of general creditors were superior to those of a preferred stockholder,

whose certificate contained an agreement by the corporation to redeem the amount thereof at a specified time, which agreement was presently secured by a first mortgage lien of the corporate property. Assuming, in the instant case, that the mortgage bonds and trust deed securing same were in effect a present security for such stock, the case would then be no stronger than that under consideration in *Spencer v. Smith et al.*, above, at least until such stock is converted into bonds.

It appears that the taxpayer, by amending its articles of incorporation, fixed its capital stock at 45x dollars, of which y shares were to be preferred. The first preferred stock was therefore designed as, and was directly declared to be, a part of the capital stock of the corporation. These facts are identical, apart from the amounts stated, with the facts in the case of *Armstrong v. Union Trust & Savings Bank*, cited above. Upon a purchase of stock, under these circumstances, the intention of the parties is conclusively presumed to be that such purchasers become stockholders and, on a distribution of assets to pay debts, their rights are inferior to creditors.

It is concluded that the preferred stock under consideration in the instant case is part of the capital stock of the corporation and that the rights of the holders thereof are inferior to the rights of general creditors. Determined by the rule stated in article 812, Regulations 45, such preferred stock is, therefore, invested capital and not borrowed capital.

It is held that preferred stock, if in the records of the corporation it is declared to be part of its capital stock, though convertible into first mortgage bonds of even date therewith, is inferior, on a distribution of assets to pay debts, to the rights of general creditors, and is to be treated as invested capital so long as it is not converted.

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21-20-962: A. R. R. 116.

## REVENUE ACT OF 1917.

Held in the matter of the appeal of the O Company (Inc.), that the debenture bonds in the amount of 10x dollars can not be included in the computation of its invested capital.

The Committee on Appeals and Review has had under consideration the appeal of the O Company from a decision of the Income Tax Unit eliminating an item of 10x dollars from the invested capital of this corporation.

It appears that prior to 1911 the business was conducted as a copartnership. The copartnership transferred its assets to the O Company and received in payment therefor debenture bonds in the amount of 10x dollars, payable in 30 years, bearing interest at the rate of 6 per cent per annum. The copartnership also received other good and valuable consideration in the form of common stock in the amount of 20x dollars, which was issued against good will, trade-marks, etc. The debenture bonds issued in payment for the assets of the copartnership were delivered to the partners pro rata. The common stock issued was distributed to the partners in the same ratio as the bonds. The debenture bonds were issued in payment for the tangible assets of the copartnership, which were worth approximately 11x dollars, as set forth in a schedule attached to the brief of the corporation, and the common stock was issued in payment for good will, trade-marks, etc.

The revenue agent, under date of August 21, 1919, submitted a report in which he recommended that additional taxes be assessed against the O Company for the years 1916 and 1917.

It was contended that since the resolution of acceptance of the terms of the sale by the O Company distinctly sets forth that the bonds should be



"subject to all rights of creditors of said corporation now existing and at all times existing during the term of said bonds," such bonds are in fact no more than 6 per cent preferred stock and that the property for which the debenture bonds were issued was already invested in the business and fully paid for and, therefore, the situation was not one where the corporation borrowed money against the issuance of debenture bonds and subsequently purchased goods or developed its business.

It may be conceded that the provision of the offer of sale of the partnership property and the resolution of acceptance thereof, which provided that the bonds should be "subject to all rights of creditors of said corporation now existing and at all times existing during the terms of said bonds," was fully operative (because it constituted one of the conditions on which they were issued) as between the original bondholders having actual notice and knowledge thereof, and who it appears have always retained ownership thereof, thus eliminating from consideration the situation resulting if the bonds had been held by innocent third parties. The facts therefore appear in their most favorable aspects to the taxpayers. The attorneys submitted further to substantiate the contention that these bonds were nothing more than preferred stock, that the debentures were in 1918 turned in by the owners of the O Company and preferred stock was issued in lieu thereof to the respective owners of the bonds. This, it is urged, shows that the owners of these bonds recognized that they were subordinate both as to payment of principal and interest to the rights of the general creditors of the corporation.

Where a corporation purchased certain assets, paying therefor by creating a bonded debt drawing 6 per cent interest per annum, which, though a subordinate lien to claims of general creditors of the corporation, was nevertheless superior to the rights of stockholders of the corporation, so that on a dissolution such bonds would be first paid before the stockholders could be admitted to share in the assets of the corporation, the bonds represent borrowed money and not invested capital within the meaning of section 207, Revenue Act of 1917.

Article 44(b) of Regulations 41 provides that—

The term "money or other property borrowed" as used in section 207 and these regulations includes not only cash or other borrowed property which can be identified as such, but current liabilities and temporary indebtedness of all kinds, and any permanent indebtedness upon which the taxpayer is entitled to an interest deduction in computing net income. A corporation which under the income tax law is allowed to deduct only a part of the entire interest paid upon its indebtedness, may include in its invested capital such a proportion of its permanent indebtedness as the amount of interest upon such indebtedness which the corporation is not allowed to deduct is of the total amount of interest paid upon such indebtedness during the taxable year.

Section 325(a) of the Revenue Act of 1918 provides that as used in this title:

The term "borrowed capital" means money or other property borrowed, whether represented by bonds, notes, open accounts, or otherwise.

Article 812 of Regulations 45 provides that—

Any interest in a corporation represented by bonds, debentures, or other securities, by whatever name called, including so-called preferred stock, if with respect to the payment of either interest or principal it ranks with or prior to the interest of the general creditors, is borrowed capital and can not be included in computing invested capital. Any such preferred stock may, however, be so included if it is deferred with respect to the payment of both interest and principal to the interest of the general creditors.

In general, it might be said that it is always a question of fact whether a given amount paid or left in the business of a corporation constitutes borrowed capital or paid-in surplus. The general principle is that if interest is paid, or is to be paid, on any such amount, or if the stockholders' or officers'

right to repayment of any such amount ranks with or before that of the general creditors, the amount so left with the corporation must be treated as borrowed capital.

In the instant case, the bonds were issued in payment for property, interest has been regularly paid each year and has been deducted by the corporation in computing its net income for each year up to and including 1916, but no interest deduction on account of this indebtedness was claimed for 1917, even though the corporation actually paid 6 per cent on the outstanding debenture bonds.

The Committee is of the opinion that the O Company is not entitled to include in the computation of its invested capital the item of debenture bonds on which interest was paid but not deducted in the computation of the invested capital for 1917. The corporation will, however, be entitled to a deduction in computing its net income of the interest so paid on these bonds within the statutory limitation with respect to the payment of interest for the year 1917.

The intent of the parties in this case was truly reflected in the form in which they organized their corporate business. They chose to organize and carry it on by creating a corporate debt to be repaid at a future date, plus a fixed rate of interest evidenced by the debenture bonds secured by a lien on corporate assets, subordinate to claims of its general creditors. Bondholders have different rights or interests in corporate business and assets than would preferred stockholders. True, preferred stock might have been issued in lieu thereof, but the parties elected otherwise, and they are bound by their act so long as the bonds in question are outstanding. The subordination of the lien of the bonds to claims of general creditors is not enough to render the bonds the equivalent of preferred stock. Nor is the mere fact that possibly in an effort to characterize the bonds as the equivalent of preferred stock the corporation did not deduct interest thereon in filing its return for 1917 sufficient to change or fix their status.

A memorandum supplementing the original brief has been filed in which the attorneys refer to and quote from certain court decisions to the effect that, as between the corporation and the original purchasers, the bonds were subordinate both as to the payment of principal and interest to the rights of the general creditors. The bonds in question are an obligation of the corporation to pay and in the judgment of the Committee should be classed as "borrowed capital."

The Committee therefore recommends that the decision of the Income Tax Unit disallowing the item of 10x dollars from the invested capital of the O Company be sustained and that the case be otherwise closed in accordance with this recommendation.

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33-20-1142: A. R. R. 237.

Recommended in the appeal of the M Company that the decision of the Income Tax Unit holding that amounts received from the sale of so-called debenture stock constitute part of the invested capital of the corporation and that the interest paid thereon does not constitute an allowable deduction in the computation of net income, be reversed.

The Committee has had under consideration the appeal of the M Company from a decision of the Income Tax Unit holding that the amounts received from the sale of so-called debenture stock shall be treated as part of the



invested capital and that the interest paid thereon can not be deducted in the computation of net income.

The ruling in question was as follows:

It seems clearly to be the intent of the corporation to subordinate the payment of the principal of the debenture stock in question to the claims of the general creditors.

You are advised, therefore, that the amount received from the sale of these stocks constitutes a part of the invested capital of the M Company, and must be included in the computation of that item. The company is not permitted, in its option, to treat this amount as borrowed capital.

You are advised, further, that the payments of interest on these stocks in reality are dividends, and as such are not to be deducted by the corporation in computing its taxable net income.

It is from this rule that the corporation has appealed to the Committee. Since the questions raised by the corporation were questions of law and not of fact, the Committee requested advice from the Solicitor and under date of July 7, 1920, the following opinion was received:

The war profits and excess profits tax, being Title III of the Revenue Act of 1918, provides, in part, as follows:

"Sec. 325(a) That as used in this title—

The term 'borrowed capital' means money or other property borrowed, whether represented by bonds, notes, open accounts, or otherwise; \* \* \*

Sec. 326(b) As used in this title the term 'invested capital' does not include borrowed capital. \* \* \*

Elsewhere in the Act it is provided—

"Sec. 234(a). That in computing the net income of a corporation subject to the tax imposed by section 230 there shall be allowed as deductions:

(2) All interest paid or accrued within the taxable year on its indebtedness, \* \* \*"

The M Company was duly incorporated under the laws of the State of Delaware under a charter which provided that its capital stock should be divided into  $x$  shares without nominal or par value, and which authorized the corporation under the general power to borrow money to issue a form of obligation in the nature of certificates of indebtedness to the extent of  $100x$  dollars, which should be known as debenture stock. Pursuant to the latter named power the M Company issued for cash to the face value thereof  $100x$  dollars of such debenture stock, represented by certificates reading, in part, as follows:

"THIS IS TO CERTIFY THAT THE M COMPANY \* \* \* HEREBY acknowledges itself indebted to . . . . ., in the sum of . . . . . Dollars, principal payable at the expiration of the corporate existence of the corporation, interest at the rate of  $y$  per cent per annum payable semiannually on the first days of . . . . . and . . . . . in each year in gold coin of the United States of America, of the present standard of weight and fineness, represented by . . . . . shares of debenture stock of the corporation, each of the par value of one hundred dollars.

"In the payment of their superior claims, all creditors, other than the stockholders of the corporation, shall rank *pari passu* to the holders of the debenture stock, but all holders of debenture stock shall rank *pari passu* with each other, and superior to the stockholders of the corporation, with respect to their share stock.

"The corporation shall, nevertheless, have the right, the interest on the debenture stock having been paid, from time to time to declare and pay dividends out of the net earnings, upon the stock or share capital of the corporation.

"The debenture stock shall be subject to redemption by the corporation upon any interest date, upon the affirmative vote of two-thirds in amount of the capital stock of the corporation then issued and outstanding, at the rate of one hundred twenty-five dollars per share for each one hundred dollars of the principal or par value, plus all unpaid accrued interest, including interest at the aforesaid rate of  $y$  per cent per annum up to the time of redemption.

"Neither the corporation nor its shareholders shall have power to mortgage the property or franchises of the corporation, except by the written consent of the then registered holders of at least two-thirds in amount of the debenture stock. \* \* \*"

The company in its return of annual net income under the Revenue Act of 1918, deducted from gross income, among others, the amount of interest paid by it upon the above mentioned certificates of debenture stock. This deduction was disallowed by the Income Tax Unit on the ground that the holders of such stock were in reality preferred stockholders, and amounts contributed by them were part of the invested capital of the corporation and that interest paid was in reality in the nature of dividends.

Recognizing that the true character of an interest in a corporation is not determined solely by its name, article 812 of Regulations 45, provides:

"Any interest in a corporation represented by bonds, debentures or other securities  
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by whatever name called, including so-called preferred stock, if with respect to the payment of either interest or principal it ranks with or prior to the interest of the general creditors, is borrowed capital and cannot be included in computing invested capital. Any such preferred stock may, however, be so included if it is deferred with respect to the payment of both interest and principal to the interest of the general creditors."

If the instrument in question creates or evidences a debt, it will be given the characteristics of such obligation, regardless of its name. *Spencer v. Smith*, C. C. A. 8th Circ. 201 Fed. 647; *Heller v. Marine Bank*, 89 Md. 601.

In the latter named case the court, passing upon the question whether certain so-called preferred stock was in fact entitled to priority, stated the general rule as follows:

"The question in such cases is, not what did the parties call it, but what do the facts and circumstances require the court to call it. Courts are not influenced by mere names. They look beyond these and give to the subject dealt with the character—the status—which its properties denote it possesses. The qualities and properties of a thing are its essentials—they define and mark what it is—the name is purely accidental—it is no part of the thing named."

The term "debenture" is well known in England to describe any instrument issued by a corporation which creates or acknowledges a debt. *Cook on Corporations*, 6th ed. 2709.

"Debenture stock is of the same nature as ordinary debentures, except that instead of each bond securing a definite amount, the whole sum secured is treated as a single stock, and bonds are issued declaring the holder to be entitled to a definite sum, part of this stock. This sum is not necessarily a round sum, but may be for any number of pounds, it may include fractions of a pound unless limitation is made in that respect. A debenture stock may be repayable at a fixed date, or may be irredeemable, according to the deed creating it, and may be secured in any manner in which a debenture may be secured." See *Lindley's Company Law*, 195.

As used in this country the term "stock" does not mean a debt, but simply an interest in the corporate enterprise.

Examining the provisions of the certificates of so-called debenture stock in question, it seems clear that the parties in interest intended to and did create or acknowledge a definite obligation on the part of the corporation to repay a specified sum of money. In other words, the certificates in question are more nearly related to bonds or notes or certificates of indebtedness than to certificates of preferred stock. It will be noted that the certificates state that the corporation is indebted in a specified amount to the holders thereof payable at the expiration of the corporate existence. Irredeemable notes or bonds are of comparatively common occurrence in England, although not so well known in this country. There are instances, however, of such perpetual debts, and courts have held that the character of such obligations is not affected by the fact that they are not redeemable at a fixed time. Thus, in *Philadelphia & Reading Railroad Company v. Stichter*, 11 Weekly Notes of Cases, Pennsylvania, 325, it was held that it was not *ultra vires* for a railroad company to raise funds by issuing bonds at a large discount. It will be noted that payment of the principal is subordinated to other indebtedness of the company. This feature, however, does not preclude regarding the obligation as a debt, for I know of no principle of law which prevents corporations from creating priorities among creditors. It should be noted that some security is given to the holders of these certificates by the provision which prevents the corporation from mortgaging its property or franchises without the written consent of at least two-thirds of the holders of such debenture stock. As corollary there are no indications that the parties intended the holders of these certificates to be stockholders. In the first place, the certificates are issued under a power granted in the charter to borrow money, and not to issue stock.

It is elementary that a corporation cannot issue stock except under authorization of its charter. See *Cook on Corporations*, 6th ed. 268. Secondly, the certificates provide specifically for the payment of interest at a specified rate per annum. No qualification is found in the charter or in the by-laws limiting this obligation, and there is no reason why the holders of such certificates cannot sue for the interest if default is made in payment. This, of course, is foreign to the idea of preferred stock, for it is well settled that a preferred stockholder is not a creditor of the corporation. *Warren v. King*, 108 U. S. 389.

A preferred stockholder may not sue for dividends unless they are declared, and a provision guaranteeing the payment of dividends is absolutely void. *Cook on Corporations*, 6th ed. sec. 271.

Finally, there is nowhere to be found in the charter or in the by-laws any indication of an intent that the holders of such certificates shall share in the assets of a corporation over and above the face amount of their interest.

As stated by attorneys for the M Company:

"The holders of such debenture stock certificates do not have any share in the profits of the business in any way whatsoever, irrespective of the amount of profits made in any one year or over a score of years, and no dividends could be declared on these certificates of indebtedness. And in the event of the dissolution of the company if there should be



assets remaining at that time, more than sufficient to repay the face value of the certificates of obligation called debenture stock, as well as the capital contributed by the holders of the ordinary capital stock, the debenture stockholders would not share in this excess. By the express terms of the charter the holder of a debenture stock certificate obtains no more at any time than the amount of the principal with interest thereon payable semiannually."

It is held, therefore, that whether or not amounts received by a corporation upon the sale of so-called debenture stock constitute invested capital or borrowed capital depends upon the rights and powers enjoyed by the holders of such stock and the obligations with respect thereto undertaken by the corporation; that where so-called debenture stock is issued by a corporation for cash or property under a power granted by the charter to borrow money, and the certificates of such stock contain an agreement on the part of the corporation to repay the face amount thereof upon dissolution, and to pay interest thereon from time to time, at a certain rate per cent per annum; and where it appears that the claim of such debenture stockholders will, upon dissolution of the corporation, be subordinate to the claims of general creditors but superior to the claims of the ordinary stockholders; and where it further appears that the holders of such certificates exercise no voice in the control or management of the corporation, the amounts received for the sale of such stock constitute borrowed capital, and the interest paid thereon, from time to time, by the corporation is properly deductible as a business expense.

In view of the foregoing advice from the Solicitor, the Committee recommends that the action of the Income Tax Unit be reversed and that the amounts received by the M Company from the sale of the so-called debenture stock be treated as borrowed capital, and that the interest paid thereon be allowed as a deduction in computing the net income.





**Law Section 325.—Terms Relating to Invested Capital (1918 Act—¶548, ante): (1921 Act—¶1028, post).**

**Article 813.—Borrowed Capital—Amounts Left in Business (Reg. 45—¶740, ante): (Reg. 62, ¶1181, post).**

23-19-552: T. B. M. 82.

Excess profits tax—Surplus paid in by stockholders.

The M Company was organized in 1910 with a capital stock of 10x dollars. Such stock was subscribed for as follows: A, all but 2 shares; B, 1 share; and C, 1 share. All the capital represented by this stock was actually furnished by A; the other stockholders holding their stock for him. No change in stock ownership took place, and during 1915 A paid into the company 7x dollars. No action was taken by the corporation which would indicate the nature of this payment, except that it was entered upon the company's books as a contribution to capital and was never treated as an account payable. No stock was issued and no interest was charged on this amount. During 1917 this money was repaid by the corporation to A. No evidence is presented to indicate the nature of this payment or how it was treated by the corporation. The company contends that this sum should be included in invested capital for the proper part of the year 1917.

It is evident that the formalities of proper corporate action have in this case been disregarded. This makes a determination of the exact relation between A and the corporation with reference to the 7x dollars very difficult. Article 813, Regulations 45, contains the general principle:

That if interest is paid or is to be paid on any such amount, or if the stockholders' or officers' right to repayment of such amount ranks with or before that of the general creditors, the amount so left with the corporation must be considered as borrowed capital and be so treated in computing invested capital.

It is accepted legal doctrine that where stockholders voluntarily assess themselves to relieve the corporation from pecuniary embarrassment or for the betterment of their stock, whatever may be the occasion of the assessment, the advances thus made are not debts against, but assets of, the corporation. (*Broderick v. Brown*, 69 Fed., 497.)

It is the opinion of the Advisory Tax Board that this payment was in the nature of a voluntary assessment by the one who was practically the sole stockholder of the corporation, and that after it was paid to the corporation no obligation to repay it existed. The treatment of this payment by the corporation upon its books (undoubtedly with the knowledge of A) is highly significant and would undoubtedly postpone A to the general creditors of the corporation as to this amount. The repayment of this sum in 1917 to the stockholder must be deemed to be out of undivided profits or earned surplus so far as possible. (Section 31(b), Revenue Act of 1916, as amended.) While this distribution was informal, it can not be treated as a return of capital unless the undivided profits and earned surplus accumulated since 1913 are first distributed as dividends. Whether or not such repayments will reduce the invested capital will depend upon the amount of current earnings available for distribution at the time of such repayment.

It is therefore recommended that the M Company be permitted to include in its invested capital for the taxable year 1917 the sum of 7x dollars as a surplus paid in by the stockholders, proper adjustment being made for any distribution of dividends in excess of available net earnings.

Advice has been requested as to whether an amount paid into a corporation ratably by its stockholders under corporate resolution authorizing and

making the assessment can be properly treated as invested capital of the corporation, even though its books indicate and show that the amount so paid in has been treated as a loan; that interest has been regularly paid to the contributing stockholders and that the corporation has regularly deducted the interest so paid in making its returns up to 1917.

A revenue agent submitted a report of his examination of the tax liability of this company and recommends the elimination of the amount so paid in from its invested capital for the reason that such amount has been treated on the books of the company as borrowed capital and further, for the reason that it has regularly each year in computing its net income deducted interest on this amount at the rate of 5 per cent per annum. No capital stock was issued for this amount of money paid in and no notes were given by the corporation acknowledging its indebtedness to the stockholders for this amount.

The amount paid in in accordance with the corporate resolutions was entered on the books of the company as a capital reserve fund and in 1917 it was carried as "Advances by stockholders."

The company urges strongly that this amount is not borrowed money. It is urged by the taxpayer that it makes little difference whether or not interest was paid on this amount and it submits that the payment of the interest is not determinative of the question involved. The payment or non-payment of interest, it is contended, does not change the character of this capital and whether such capital is borrowed money or paid in surplus must be determined by the facts and by the intentions of the parties. This can best be determined from the books and records of the company. The taxpayer submits that its records clearly show that the amount was paid in as assessments in pursuance of corporate resolutions duly passed by the board of directors and that the amount so paid in was set up on the books as "Reserve capital." The company further urges that inasmuch as no notes or other evidences of indebtedness were issued for this money, there was no obligation to repay same to the contributors other than that attaching with respect to the original capital.

Section 207 of the Revenue Act of 1917 provides that, as used in this title, "Invested capital" does not include stocks, bonds (other than obligations of the United States), or other assets, the income from which is not subject to the tax imposed by this title, nor money or other property borrowed.

Article 44 of Regulations 41 provides, in part, as follows:

The term "money or other property borrowed" as used in section 207 of these regulations includes not only cash or other borrowed property which can be identified as such, but current liabilities and temporary indebtedness of all kinds, and any permanent indebtedness upon which the taxpayer is entitled to an interest deduction in computing net income. A corporation, which under the income tax law is allowed to deduct only a part of the entire interest paid upon its indebtedness, may include in its invested capital such a proportion of its permanent indebtedness as the amount of interest upon such indebtedness which the corporation is not allowed to deduct is of the total amount of interest paid upon such indebtedness during the taxable year.

The Committee has considered all the facts presented in this case and has reached the conclusion that the money paid into the company under corporate resolution for which no notes were given nor even authorized does not fall within the provisions of article 812, Regulations 45. It is not thought that any court of equity or law would permit the repayment of this money ratably to the stockholders and interest thereon before the general creditors had been satisfied. If this assumption be correct, then assessments paid in would be subordinated to the rights of the general creditors as to the payment of both the principal and interest thereon.

Therefore, after careful consideration of the brief submitted by the com-



pany, and the recommendations of the revenue agent in this case, it is the opinion of the Committee that in determining the invested capital of this corporation the minute books of the corporation showing the resolutions making the assessment against the stockholders, reflect more clearly the true nature of the transaction than do mere bookkeeping entries concerning the same transaction made at a later date by a subordinate officer of the corporation. Although the sums paid to the stockholders as a return on their capital on account of these assessments were noted on the books of the corporation as interest, the facts indicate that such payments were more in the nature of dividends. The books of the corporation treat the amounts paid by assessment as an obligation of the corporation. This is true, but so also are amounts paid in for capital stock carried as liabilities of a corporation. The resolutions authorizing the assessments do not provide that interest shall be paid to the stockholders, no notes or other evidence of indebtedness are given by the corporation, and the stockholders are not preferred over general creditors as to the amounts paid in assessments.

Held, that the corporation may include in its invested capital for 1917 the amount assessed against its stockholders and paid in by them.

2

## 21-20-963: A. R. R. 102.

## REVENUE ACT OF 1917.

Held in the appeal of the M Company that the amount of 36x dollars standing upon the books of the company to the individual credits of three stockholders, at the beginning of business July 1, 1916, is not invested capital within the meaning of the Revenue Act of 1917

The M Company is a corporation, all of the stock of which was owned by three stockholders, A, B, and C. During the lifetime of these stockholders no distribution of profits was made and the earnings were allowed to accumulate from year to year.

At the death of A, in 1907, the board of directors passed a resolution ordering the reserve fund to be prorated and credited to the deposit accounts of the three principal stockholders.

In accordance with this resolution the accumulated profits were divided and placed to the credit of these various accounts. None of these profits was withdrawn; the business proceeded as before and the profits were allowed again to accumulate until 1909, when B died, and the same procedure was taken as in 1907; although it does not appear in the record that there was formal action on the part of the directors, nor is the rate of the division nor the total amount divided, shown.

From the inception of the business until the present day no dividend has been declared nor have any of the profits been withdrawn from the business or segregated from the surplus of the company except as hereinbefore stated; but against the accounts credited as above, comparatively small charges have been made from time to time to cover living expenses of two of these stockholders. It is contended and sworn to that substantially all of the profits thus credited to these three stockholders have been, by verbal agreement, left in the corporation funds for the conduct of its business and that on the amounts so credited no interest has ever been paid by the corporation nor have notes been issued therefor, for the reason that they never have been considered as obligations of the corporation; but, on the contrary, as funds left in the business to be used as capital; and deponents further de-

clare that the banks and other large creditors of the corporation were, and are, cognizant of this verbal agreement, and by reason of it extend credit to the corporation on these funds considered as capital.

In support of this sworn statement there were submitted two identical affidavits of the presidents of two banks, to the effect that the amounts carried on the books to the credit of the stockholders were considered by their respective banks as capital left in the business of the corporation by those parties under a verbal agreement, and that on the strength of this agreement and the indorsement or guaranty given to these banks by the individuals named, credit was extended by these banks to the corporation; these credits amounting to 12x dollars and 25x dollars, respectively.

On this statement of facts, which is not contested by the Income Tax Unit, the taxpayer appeals to this Committee to have these credits to these individual stockholders, which on July 1, 1916, amounted to 36x dollars considered as invested capital of the corporation; the Unit having denied such consideration.

Section 207 of the Revenue Act of 1917 provides that—

\* \* \* As used in this title "invested capital" does not include \* \* \* money or other property borrowed, and means, subject to the above limitations:

(a) In the case of a corporation or partnership: (1) Actual cash paid in, \* \* \* and (3) paid in or earned surplus and undivided profits used or employed in the business, \* \* \*.

In the consideration of this case no question of good faith or of fact is involved. There is no doubt that these amounts have been left in the business in accordance with the verbal understanding above referred to, to be used as capital, or that they have been so used as necessary contributions to the working capital of the business, which has expanded so rapidly that their withdrawal would at all times have rendered necessary some provision for the financing of the company upon some other basis.

It is contended in the taxpayer's brief and was reasserted at an informal oral hearing before this Committee on April 10, at which the taxpayer was represented by its president, that these amounts, which admittedly constitute a considerable part of the actual working capital of the business, should be, by reason of that fact, regarded as a part of the invested capital of the business within the meaning of the Revenue Act of 1917. In support of this contention the taxpayer advances the argument that these credits and the funds representing them have been regarded as a part of the capital of the corporation by the banks with which it does business and which loan it large amounts of money by reason of these credits as well as by its other large commercial creditors.

The taxpayer contends that the intent of these stockholder-creditors, rather than the letter of the law, should prevail in the consideration of this case and that the good faith behind such intent has been amply and conclusively demonstrated by the fact that these amounts have been left in the business over a period of more than 10 years, to the actual and material financial detriment of these creditors by reason of the fact that the funds representing these amounts have been actively and continuously used in the conduct of the business and in earning profits for the stockholders, from which profits these creditor stockholders derive no advantage beyond the general pro rata participation in the earnings enjoyed by all the stockholders alike.

The taxpayer further contends that it should not be penalized in 1917 merely because of its failure to have made a "book entry," converting these credits into capital stock.

The Committee has given due and earnest consideration to all the facts



in this case and to the arguments presented by the taxpayer; but it can not see its way clear to accept the taxpayer's views.

Under section 207 as quoted above, these credits are, in law, obviously either borrowed money or earned surplus and undivided profits. The very purpose for which and the circumstances under which they were created excludes them from consideration as "surplus and undivided profits." It was to determine exactly the equities of these three stockholders in the profits or surplus, until that time undivided, that these credits were established. The president of this corporation vigorously denies that they are "surplus" of the company in the sense that all the present stockholders have a right to share in them ratably, and admits that these rights of these three stockholders would be asserted as against the other stockholders, though not against the general creditors. That being true, they form no part at all of the "surplus" of the corporation, and the alternative that they are borrowed money can not be escaped.

Article 813 of Regulations 45 provides that—

Whether a given amount paid into or left in the business of a corporation constitutes borrowed capital or paid-in surplus is largely a question of fact. Thus, indebtedness to stockholders actually canceled and left in the business would ordinarily constitute paid-in surplus, while amounts left in the business representing salaries of officers in excess of their actual withdrawals, or deposit accounts in favor of partners in a partnership succeeded by the corporation, will be considered paid-in surplus or borrowed capital according to the facts of the particular case. The general principle is that if interest is paid or is to be paid on any such amount, or if the stockholder's or officer's right to repayment of such amount ranks *with or before that of the general creditors*, the amount so left with the corporation must be considered as borrowed capital and be so treated in computing invested capital.

These credits unquestionably rank, in law, with the claims of other general creditors; even though by the good faith and honor of these three stockholders, they would be voluntarily deferred until the claims of the other general creditors had been liquidated in full.

The Committee, moreover, can not concede the corporation's contention that it is being penalized merely because of its failure to have made a "book entry" converting these credits into capital stock; because there can be no doubt that these credits being a direct and fixed obligation of the corporation, have not at all the same status among the corporation's liabilities as would have been the case had they, by formal action of the board, been converted into capital stock and certificates issued therefor, or had the interested stockholders waived all proprietary rights to them and thus actually contributed them to surplus.

Therefore, the Committee is of the opinion that the Income Tax Unit was correct in disallowing as invested capital this amount of 36x dollars and the action of the Unit is confirmed.

3

52-20-1366: A. R. R. 356

#### REVENUE ACT OF 1917.

Held, that special accounts in a corporation, represented by interest-bearing notes in the hands of certain stockholders, cannot be included in invested capital, even though such notes carry a condition that demand for payment will not be made until all general credits are satisfied.

The Committee has had under consideration the appeal of the M

Company, a corporation, from the action of the Income Tax Unit in disallowing an item of 3 dollars as invested capital, this amount having been paid into the corporation by certain stockholders and held, at interest, under certain conditions as working capital of the corporation.

This company was incorporated July, 191-, with an authorized capital stock of 4x dollars of which only 3x dollars has been paid in. Its business is conducted on the same general plan and by practically the same individuals who were copartners in the predecessor company. Prior to the incorporation, the partners had allowed a portion of their earnings to remain in the business, such amounts being credited as "Special Accounts" of partners. When the partnership was liquidated certain partners returned their pro rata share in distribution to the corporation and on the books of the corporation amounts so paid in were again credited to certain "Special Accounts." Since the incorporation certain other amounts, acquired by declaration of dividend, have been credited to these accounts. It is stated that it was the intention of the stockholders, as it had been the custom of the partners, to allow this fund to be used in the business of the company so long as it was necessary, subject to all the debts of the corporation as fully as though it had been paid in for capital stock.

It is accordingly contended by the corporation that the entire amount so credited to the special accounts is "Surplus accumulated during the existence of the partnership and the existence of the corporation—while technically the amount received from the partnership cannot be treated as a surplus of the corporation, still so far as the individual interest of the stockholder is concerned, it is the same thing as though the entire amount was an accumulated surplus of the corporation."

These special accounts of the corporation are now covered by notes, the pertinent part of which reads as follows:

By mutual agreement and consent, *demand for payment* of this note is not to be made by ....., his heirs or assigns, until all of the indebtedness of the M Company, for money borrowed, merchandise bought and delivered, together with unfilled contracts for merchandise bought which may be outstanding when notice is given that payment is desired, has been fully paid and satisfied. This note is nonnegotiable.

The Income Tax Unit has denied the inclusion of these special accounts for invested capital for the following reasons:

1. They represent advances made by the stockholders from time to time but not in proportion to stockholdings and, therefore, do not represent paid-in surplus.

2. They were secured by notes which were payable on demand provided all obligations outstanding at the time demand was made were satisfied, and accordingly the obligation of the notes is inferior to claims of general creditors only until the date when notice is given that payment is desired.

3. The notes contain an absolute and unconditional promise to pay interest every six months, which promise is not modified by the provision subrogating the principal of the notes to the general creditors, and accordingly the notes could not be considered in the light of preferred stock.

The Committee finds this case quite analogous to that covered by its recommendation No. 102. (Cumulative Bulletin No. 2, page 277.) The following exceptions of importance, however, are noted:



1. The special accounts, as indicated, represent loans only by special stockholders.

2. Interest is paid on such loans.

3. An agreement in the notes to the effect that demand for payment is not to be made until all indebtedness of the corporation is liquidated.

4. The guarantee of certain stockholders to be individually responsible for the entire debts of the corporation to the extent of the private resources of such stockholders.

The stockholders are ten in number. Of this ten, five are owners of the so-called "Special Accounts" for which the above-mentioned notes were given. The liability, therefore, is not to all of the stockholders, pro rata according to the shareholdings. It is not an undivided amount which may be distributed pro rata in liquidation. The amounts so retained in the business are subject to interest charges and interest is actually accrued but it is apparently credited to the special accounts in part or in whole. There is an obligation on the part of the stockholders directly interested in the special accounts, not to demand payment of the notes supporting these special accounts until the indebtedness of the corporation is fully paid and satisfied but this agreement does not preclude the corporation as a distinct entity from liquidating these liabilities at such time as it may be deemed proper and in accordance with the tenor of the notes—not pro rata according to shareholders in the corporation. Furthermore, as stated by the Income Tax Unit: "The notes contained an absolute and unconditional promise to pay interest every six months, which promise is not modified by the provisions subrogating the principal of the notes to the general creditors and accordingly the notes could not be considered in the light of preferred stock."

It is further stated in affidavit submitted by the five stockholders, who financially give independent support to the corporation, that they are "guarantors of the debts of the corporation on guarantees given by the corporation to our banks and brokers and each and every one of us is individually liable on these guarantees for the entire debts of the corporation up to the extent of our private means as fully as though we were members of a partnership." This obligation establishes a right of action against the stockholders individually and not against the corporation. As against the corporation it would not be enforceable at law, which limits the liability of the stockholder to his share of paid-in capital.

Briefly, it may be stated that capital in a corporate enterprise is:

1. Cash or property paid in by subscription to capital stock or as paid-in surplus.

2. Borrowed money for which obligations of the corporation may be issued.

3. Undivided increment of income resting in the surplus of the corporation.

Manifestly these "Special Accounts" do not represent either stock subscriptions or undivided increment of income. In the latter the shareholder's interest is measured by his pro rata share interest in the corporation. This undivided increment of income is not a vested right. Borrowed capital is not invested capital under section 207 of the Revenue Act of 1917, which reads:

\* \* \* As used in this title "invested capital" does not include \* \* \* money or other property borrowed, and means, subject to the above limitations:

(a) In the case of a corporation or partnership:

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- (1) Actual cash paid in, \* \* \* and
- (3) Paid-in or earned surplus and undivided profits used or employed in the business \* \* \*

It seems pertinent at this point to quote from the recommendation of this Committee (102), *supra*:

Under section 207 as quoted above, these credits are, in law, obviously either borrowed money or earned surplus and undivided profits. The very purpose for which and the circumstances under which they were created excludes them from consideration as "surplus and undivided profits." It was to determine exactly the equities of these three stockholders in the profits or surplus, until that time undivided, that these credits were established. The president of this corporation vigorously denies that they are "surplus" of the company in the sense that all the present stockholders have a right to share in them ratably, and admits that these rights of these three stockholders would be asserted as against the other stockholders, though not against the general creditors. That being true, they form no part at all of the "surplus" of the corporation, and the alternative that they are borrowed money cannot be escaped.

Accordingly the Committee recommends that the conclusions of the Income Tax Unit in denying these "Special Accounts" as invested capital, be sustained under section 207 of the Revenue Act of 1917.

4

17-21-1602: A. R. R. 473

Recommended, in the case of the M Company, that treasury demand notes drawn by order of the president of a corporation payable to its stockholders, but not in proportion of shareholdings, do not constitute a liability of the corporation even though such notes are charged against surplus on the books of the company.

The Committee has had under consideration the appeal of the M Company from the action of the Income Tax Unit in disallowing the item of  $x$  dollars as invested capital in the taxable year 1918 on the ground that the item constituted notes of the corporation in the hands of its stockholders.

The facts, as submitted, are as follows:

The company had prior to December 31, 1910, acquired a paid-in and earned surplus of  $x$  dollars, represented by increased inventory stock, capital expenditures on machinery, plant, and equipment, and accounts receivable and notes receivable, thus absorbing the whole of this amount in the conduct of the business.

At this time the president of the corporation instructed the secretary of the company to make demand notes out in the names of the stockholders for their respective interests in the  $x$  dollars, merely as a memorandum of the amount representing such interest, and not as an obligation of the company.

The board of directors never authorized the issue of these notes, and there is no resolution on the records of the corporation authorizing the issue of these notes; said notes were never issued to the respective stockholders, but were retained by the treasurer of the corporation, and are to-day in his possession. The notes were made without any reference to payment of interest, or principal, and no interest has been paid, or credited to the accounts of the respective stockholders, and furthermore it was not the intent when these notes were made out to pay either the principal or interest, as the company was never in a financial position to liquidate this amount.

No entry was ever made on the books of the company apportioning this amount to the respective stockholders, the amount reading "undivided surplus."

These facts are not disputed by the Income Tax Unit, but the Unit contends that the demand notes in the amount of  $x$  dollars issued to the stockholders of the corporation in effect represent borrowed capital and, therefore, should be disallowed as statutory invested capital in accordance with Article 813 of Regulations 45.

The Unit has evidently overlooked the fact that a corporation can not, without consideration, issue notes to its stockholders for the amount of its surplus, except by declaration of dividends prorata according to stock-



holdings, for the stockholders have no vested right in the surplus of a corporation. If this transaction was intended as a dividend with the accrued liability covered by demand notes, it was not sanctioned by formal resolution of the directors.

It is manifest the issuance of the notes was not for the purpose of setting up a dividend liability, because the company states, and its statement is not controverted, that no apportionment of the  $x$  dollars was made prorata according to shareholdings of the stockholders. The action taken by the secretary of the company was on instructions from its president, and the only entry made was to debit surplus to the credit of notes payable.

Furthermore, delivery of demand notes by the maker is essential to negotiability, and as long as these notes remain in possession of the corporation without formal declaration of distribution of surplus prorata according to shareholdings under formal action of the corporation, they can not be held to constitute a liability.

The Committee accordingly is of the opinion that the action of the Income Tax Unit in considering this amount as borrowed capital should be reversed.

5

34-21-1786: O. D. 1006.

A Massachusetts corporation declared dividends as follows: November, 1916,  $x$  dollars; December, 1916,  $x$  dollars. These dividends were credited to the respective accounts of the shareholders with the understanding that they were not to be drawn against, and were not to bear interest, since the corporation needed the capital and it did not possess the cash with which to make actual payment. These dividends have been treated as liabilities of the corporation from 1916 down to date, and no interest has been paid or accrued thereon. The first dividend was formally declared by the board of directors, but the second dividend was credited to the stockholders, under an agreement that it was to be like the first dividend, although its declaration was not recorded in the minutes book of the corporation.

The corporation requests permission to use these amounts credited to the stockholders' accounts as a part of its invested capital.

Held, in view of Massachusetts court decisions that the dividend formally declared by the board of directors and credited to the accounts of the stockholders on the books of the company was a distribution of part of the corporation's surplus. From the date of its declaration the corporation became a debtor and the stockholders became creditors, ranking with general creditors in their right to reduce to possession the amounts credited to their accounts.

The amounts of surplus agreed to be credited to the stockholders' accounts by all the stockholders without formal action on the part of the directors was equivalent to a dividend. Its effect on the corporation's surplus and the rights of the stockholders are exactly the same as though the dividend had been formally declared.

While the corporation may have had the use of the amounts credited to the stockholders, it was at all times liable to them for payment. Viewed in this light, the corporation's surplus must be reduced from the date the first dividend was formally declared and from the date the agreement was made informally to further credit stockholders' accounts with profits.

6

37-21-1821: O. D. 1034.

A corporation filed a return for 1920 showing a loss of  $2x$  dollars. At the close of the taxable year the corporation owed its officers  $4x$  dollars, which it was unable to pay. The officers agreed to a reduction of  $x$  dollars each, which, after the permission of this office had been granted, the officers deducted in reporting their salaries on their individual returns. A total of  $3x$  dollars was waived by the three officers. This amount was credited to surplus in January, 1921, thus wiping out the deficit which existed at the close of 1920. While this book credit was actually made in 1921 it is contended that it was really an offset to the losses of 1920, and if so regarded, the corporation would show a credit balance for 1920 of  $x$  dollars.

It is held that the amounts waived by the officers did not constitute income to the corporation. Such amounts are paid-in surplus and should be so treated in making a return for the year 1921. Therefore no amended return is required for the year 1920.

This ruling is based on the principle that there was in fact a valid obligation on the part of the corporation to pay the amounts waived by the officers. If no such obligation existed, an amended return should be filed in which the amounts claimed as a deduction on account of the salaries of the officers should be reduced, which would result in there being additional taxable income disclosed by the corporation's return.

7

I ('22)—22-322: I. T. 1334.

#### Revenue Act of 1918.

In November, 1919, the stockholders of the M Company, by proper resolution, voted to increase the capital stock of the company. In pursuance of such resolution, the officers of the company issued to everyone entitled thereto a certificate called a "stock subscription warrant" setting forth the terms upon which subscription to the stock of the new issue would be received. If such person accepted the offer to subscribe, his acceptance was indicated by signing a printed acceptance on the back of such warrant. It was provided that such warrant should be surrendered to the M Company on or before January —, 1920, accompanied by an installment payment of.... per cent of the par value of the stock subscribed for. Upon such surrender and payment the company issued to the subscriber a stock subscription certificate which read as follows:

This certifies that.....has subscribed for.....shares of the capital stock of the M Company, of a par value of \$100 each, in accordance with resolutions adopted by the stockholders on November, 1919, and has agreed to pay therefor the par value thereof, and has paid the first installment of.....per cent thereon, and that subsequent installments will be payable \* \* \* as follows:

Second installment on or before April —, 1920.

Third installment on or before July —, 1920.

Interest at the rate of 6 per cent per annum will be allowed from January —, 1920, to June —, 1920, on all payments made on or before January —, 1920, and interest at said rate will be allowed from April —, 1920, to June —, 1920, on all payments made after January —, 1920, and on or before April —, 1920. And the stock subscribed for will participate in dividends from and after July —, 1920.

Upon full and final payment as herein provided, and the surrender of this certificate, and as soon as may be practical after July —, 1920, certificate for full paid stock will be issued, and adjustment of interest will be made.

In the event of a failure to pay any of said installments when due, the company may sell the stock subscribed for at public or private sale without notice, and apply the net proceeds to the payment of the amount still payable under said subscription, accounting to the subscriber for any surplus, he to remain liable for any deficit.

This certificate may be transferred by assignment as indorsed hereon, but no transfer



hereof will be valid until this certificate is surrendered and the transfer is recorded on the books of the company.

The payments made by the subscribers were credited on the general books of the company to an account called "Received on stock subscriptions, new issue," but on the books of the transfer department an account was kept with each subscriber, crediting him with payments made and showing the amounts of interest paid him.

The M Company is a corporation organized under the laws of Texas.

Article 1145 of the Revised Statutes of Texas (See Vernon's Sayles' Texas Civil Statutes, 1914) governing increases in capital stock provides as follows:

Art. 1145. *May increase its capital stock, how.*—A corporation may increase its authorized capital by a two-thirds vote of all its stock; provided, that no stock shall be issued except for money paid, labor done, or property actually received. And when such vote is given in favor of the increase, the same may be done by the board of directors, trustees or managing board of such corporation; and, upon such increase of stock being made in accordance with the above provisions and certified to the secretary of state by the directors, together with satisfactory proof, which shall be the affidavit of the directors showing that the full amount of the increase has been in good faith subscribed, and 50 per cent thereof paid, and in other respects conforming to the proof required as on original application for charter, or showing that such portion thereof has been subscribed, or subscribed and paid, as is required for the corporation thus increasing its stock, and, if the secretary of state is satisfied that the increase of stock has been made in accordance with law and that the requirements of law have been complied with as to the subscription and payment of stock and in other respects, as on an original application for charter, he shall file such certificate of increase; and thereupon the same shall become a part of the capital stock of such corporation. Such certificate shall be filed and recorded in the same manner as the charter.

The certificate of increase, with the necessary proof to support the same, was not filed with the secretary of state until August, 1920, whereupon such increase was approved. Thereafter the subscription certificates were taken up and canceled and certificates of stock were issued to the holders thereof.

The question presented in the case is whether the payments made in accordance with the agreement evidenced by the stock subscription certificates should be treated as a part of the capital stock of the company from the time of the receipt of each such payment or should be treated as borrowed capital until the increase in the capital stock of the company was properly authorized.

Payments received by a corporation for which it is obligated eventually to issue stock, which it has no present power to issue, meanwhile paying interest, may be treated as constituting a loan until the stock is issued rather than as a payment into the capital stock of the company. (*Associated Pipe Line Co. v. United States*, 258 Fed., 800.) The nature of the agreement under which payments are received is dependent upon the intention of the parties. Under article 1140 of the Revised Statutes of Texas, every private corporation, as such, has power "to enter into any obligation or contract essential to the transaction of its authorized business." Such power includes the power to borrow money. An agreement entered into by a corporation having power to borrow money is prima facie a loan agreement if it contains provisions for the payment by such corporation of interest upon money received by it thereunder. Interest is compensation for the use of money.

Under article 1145 of the Revised Statutes of Texas, quoted above, an increase in the capital stock of a company does not become effective until a certificate of such increase has been filed with the secretary of state. This provision is very similar in its operation to article 1132 of such statutes, which provides that the existence of a corporation shall date from the filing

of the charter in the office of the secretary of state. In *Bank of De Soto v. Reed* (50 Texas Civil Appeals 102, 109 S. W., 259) it was said that performance of all the prerequisites short of filing the charter with the secretary of state is not sufficient to bring a company into existence as a corporation de jure, nor are such acts sufficient to create an association a corporation de facto. The court said that the filing of the charter in the office of the secretary of state was a necessary act to bring the corporation into existence. The requirements of article 1145 with respect to an increase of capital stock are expressly placed upon the same basis as an original application for a charter. Articles 1132 and 1145 are provisions of law *in pari materia*, and if the charter of the proposed corporation is not effective until the filing thereof in the office of the secretary of state, a proposed increase in the capital stock of a company is likewise not effective until a certificate of increase has been filed with the secretary of state. It follows that prior to complete compliance with the provisions of article 1145 a corporation has no power to increase its capital stock. The issuance of share-stock by the company before such compliance would be *ultra vires*. An unauthorized increase of capital stock is void and a subscriber to such increase incurs no liability by reason of his subscription, nor can he derive any benefits from it. The contract fails for lack of consideration to support it. (*Kampmann v. Tarver*, 87 Tex., 491; 29 S. W., 768, 769, citing *Scovill v. Thayer*, 105 U. S., 143, and *Insurance Co. v. Kamper*, 73 Ala., 325.)

The M Company had no power, therefore, to issue, prior to August, 1920, new shares of stock pursuant to the increase of its capital stock voted by the stockholders. The contract set out in the certificate quoted above evidences an understanding by the parties of this fact. It was provided that shares of stock would be issued as soon as practicable after the final payment upon the subscription was made, which may fairly be construed to mean that share-stock would be issued when the authority to do so was procured. Meanwhile the subscriber was not, of course, a shareholder or member. The company had no authority to bring him in as such. His relations with the corporation could not extend beyond his contract, which, under the circumstances, was one of purchase of share-stock to come into being in the future. Since he was not a stockholder or member he could not share in the earnings of the company. He was in all fairness, of course, entitled to a return upon the money paid in and for this reason the company agreed to pay him interest in the manner set out in the subscription certificate. There is no qualification of the subscriber's right to interest for the period specified. It was payable whether or not the company had earnings on hand when it fell due. Such interest payments can not, therefore, be considered to be distributions of profit. While the subscription contract does not contemplate a repayment of the money paid by the subscriber, the company's right to such payments was not complete until it was properly authorized to increase its capital stock. In view of this fact, together with the considerations outlined above, it is believed that the payments made to the M Company under the subscription contracts here considered should be treated as borrowed capital until the authorization to increase the company capital stock was properly secured.

It follows that the interest payments made are properly deductible as such by the company. Such payments, in the hands of the holders of the stock subscription certificates, constitute interest received and are subject to both normal tax and surtax. This is so, even if such payments were made by way of a credit to the price of the share-stock to the subscriber, in which



case such interest payments are to be treated as if received by the subscribers and immediately reinvested by applying them to the purchase price of the new stock.

8

I-('22)-37-507: A. R. R. 1004.

**Section 207, Revenue Act of 1917. Section 326, Revenue Act of 1918.**

Recommended in the appeal of the M Company, that the action of the Income Tax Unit in holding that certain items of earned surplus distributed upon appellant's books and placed to the credit of individual surplus accounts standing in the names of the stockholders do not constitute a part of invested capital under section 207, Revenue Act of 1917, and section 326, Revenue Act of 1918, be sustained, and, accordingly, that the appeal be denied.

The Committee has had under consideration the appeal of the M Company from the action of the Income Tax Unit in holding that certain items appearing on its books on January 1, 1917, and January 1, 1918, do not constitute earned surplus within the meaning of section 207, Revenue Act of 1917, and section 326, Revenue Act of 1918, and therefore are not to be included in invested capital for those years.

The appellant through its representatives, both by brief and in oral conference, has submitted arguments in support of its contention that the items involved should be treated as earned surplus used and employed in the business and as such included in the computation of its invested capital.

The facts as they appear upon the record are substantially as follows: The taxpayer was incorporated in Connecticut in 189—. The outstanding capital stock is  $x$  dollars. Prior to 1917 there were but three stockholders, two of them, A and B, owning substantially the entire capital stock in nearly equal proportions. In 1917 and 1918 there were four stockholders. A holding 52 per cent, B, 45 per cent, and two others each holding  $1\frac{1}{2}$  per cent. Until 1918 the taxpayer was engaged in manufacturing. During 1918 it was engaged in the manufacture of certain devices for the Government. Its net income for 1917 was  $10.4x$  dollars, and for 1918,  $2.3x$  dollars.

For many years prior to 1917 it was the custom of the board of directors to pass a resolution annually authorizing a distribution of the year's net income to the stockholders pro rata to their stockholdings. On January —, 1917, the directors passed the following resolution, differing from those passed annually for many years prior thereto only in the designation of the year to which it applied:

It was moved and voted that the net profit for the year ending December 31, 1916, be divided pro rata with the stockholders as the individual holdings appear and credit the amount to the individual surplus accounts standing in the names of the stockholders.

On January —, 1918, the following resolution was passed, referring to the division of profits for the year 1917:

It was moved and voted that the net profits remaining after deducting salaries, expenses, and war-profits tax be divided in the following proportions and the amounts credited to the individual surplus accounts of the stockholders:

	Per cent.
A.....	52
B.....	45
C.....	$1\frac{1}{2}$
D.....	$1\frac{1}{2}$

Pursuant to these resolutions, the amount of the surplus at the end of each year was credited on the corporation's books to the surplus accounts

standing in the names of the stockholders. From time to time the stockholders withdrew a portion of the amounts credited to their accounts without further authority from the corporation, although this was done only after consultation between A and B, the president and treasurer, respectively. Such withdrawals were never in excess of current annual earnings, except in the year 1918, and were charged by the taxpayer to the special surplus accounts bearing the names of the respective stockholders. An examination of the individual returns of the stockholders shows, and this is admitted in the affidavit of the president, A, that they reported the income when credited to their accounts and not when actually withdrawn.

The entire profits credited to the stockholders' accounts were not withdrawn immediately or in any one year, but were allowed to accumulate from time to time, and remain in the business, without interest. The aggregate amount of the accumulated earnings remaining in the business on January, 1917 and 1918 was 18.8x dollars and 19.5x dollars, respectively. The current profits and withdrawals, which do not include salary, were as follows for the years which are material here:

Year.	Current profits.	Withdrawals.
	<i>Dollars.</i>	<i>Dollars.</i>
1916.....	7.7x	3.0x
1917.....	6.1x	5.8x
1918.....	1.9x	3.5x

In connection with the income and excess-profits tax returns for the year 1917 and income and profits tax return for the year 1918, the Unit has held that the earnings and profits, placed to the credit of the individual stockholders and voluntarily left in the business without interest, should be treated as borrowed capital no part of which can be included in computing invested capital. The Unit relies upon A. R. R. 102 (C. B. 2, p. 277) and A. R. R. 133 (not published).

A computation of the tax under sections 201 and 207 of the Revenue Act of 1917 and section 301 of the Revenue Act of 1918 indicated a tax liability in excess of — per cent of the net income of the corporation for these years. The taxpayer, therefore, was granted relief under section 210 of the Revenue Act of 1917 and section 328 of the Revenue Act of 1918.

The taxpayer has declined to accept the relief granted and appeals. It contends that the surplus of the taxpayer credited to the surplus accounts in the names of the stockholders and used in the business constitute earned surplus and not borrowed money, and, therefore, is a part of its invested capital. It contends that the resolutions referred to do not constitute a legal declaration of a dividend. The taxpayer concedes that the withdrawals by the stockholders reduced the invested capital by the amounts thereof from the date of such withdrawals.

The question at issue has been considered by the Solicitor of Internal Revenue upon the basis of the facts just stated and under date of May —, 1922, he submitted to this Committee an informal opinion the pertinent portions of which are here quoted:

Section 207 of the Revenue Act of 1917, in defining invested capital, limits it among other things to the following, subdivision (a) (3):

Paid in or earned surplus and undivided profits used or employed in the business, exclusive of undivided profits earned during the taxable year.

The corresponding provision of the Revenue Act of 1918, section 326(a)3, reads:

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\* Paid in or earned surplus and undivided profits not including surplus and undivided profits earned during the year.

The questions involved here rest on whether the proportionate amounts of annual earned surplus credited to the respective individual surplus account of the several stockholders were dividends, or in whole or in part earned surplus.

Article 858, Regulations 45, in so far as pertinent here reads as follows:

A dividend other than a stock dividend affects the computation of invested capital from the date when the dividend is payable and not from the date when it is declared, except that where no date is set for its payment the date when declared will be considered also the date when payable for the purpose of this article. \* \* \* From the date when any dividend is payable the amount which the several stockholders are entitled to receive will be treated as if actually paid to them, whether or not it is so paid in fact, and the surplus and undivided profits, either of the taxable year or of the preceding years, will in accordance with the foregoing provisions be deemed to be reduced as of that date by the full amount of the dividend.

The statute of Connecticut as to dividends follows the general form as that of most States. It prohibits a corporation from paying any dividend or from making any other distribution of its assets except from its net profits or actual surplus, unless in accordance with the law as to the reduction of stock or upon dissolution.

While the resolutions referred to do not specifically refer to the amounts credited to the so-called individual surplus accounts as dividends, the purpose is clear that it was intended to make available to each stockholder at least a large part if not all of the amounts so credited. This is evidenced by the large withdrawals without any further corporate action. While the usual and proper way to appropriate corporation profits to stockholders is by formally declaring a dividend, it has been very generally held that there may be a division of profits among stockholders without the formality of declaring a dividend, and that such a division is the equivalent of a dividend. (*Smith v. Moore*, 199 Fed., 689; *Hartley v. Pioneer Iron Works*, 73 N. E., 576 (N. Y.)) And it has been held that if the directors ascertain the profits and set apart the portion thereof that is to be divided, a failure to observe the forms prescribed by law as to the time, place and manner of declaring them is immaterial. (*Breslin v. Fries-Breslin Co.*, 58 Atl., 313 (N. J.)) This is the law in Connecticut. (*Cogswell v. Second National Bank*, 60 Atl., 1059, affirmed in 204 U. S., 1.)

In the instant case the directors having ascertained the profits, and set apart certain sums which were actually credited to the individual stockholders, all matters of form are immaterial. The evidence shows that at stated times the specific things necessary to warrant a declaration of dividends were done and that the profits actually made were set apart for distribution among the stockholders. This is the essence of the declaration of a dividend, so far as it results in segregating a portion of the property of the company for the use of the stockholders. Thenceforward the corporation, as such, had no property interest in the money thus set apart. (*Breslin v. Fries-Breslin Co.*, supra; *Barnes v. Spencer & Barnes Co.*, 127 N. W., 752 (Mich.); *Cogswell v. Second National Bank*, supra (Conn.)) The effect of the declaration of a dividend is at once the establishment of a debt due from the corporation to each stockholder. (*Boardman v. Mansfield*, 66 Atl., 169 (Conn.); *Bishop v. Bishop*, 71 Atl., 583 (Conn.))

The amounts credited to the accounts of the respective stockholders were freely drawn upon and the amounts so credited reported as income by the individual stockholders when credited to their accounts. These are circumstances which are of great persuasive force in reaching a conclusion as to how the individual stockholders themselves considered the amounts so credited.

It is, therefore, the opinion of this office that the proportionate amounts of the annual earned surplus credited to the respective individual surplus accounts of the several stockholders were dividends, and that such surplus accounts were in effect debts owing at all times by the corporation to its stockholders, any withdrawal by individual stockholders merely being a debit against the proper individual surplus account. It follows that for the years 1917 and 1918 the net credit balances of individual surplus accounts can not be included in the invested capital of the M Company.

In accordance with the above opinion of the Solicitor, in which the Committee concurs, it is recommended that the action of the Income Tax Unit in holding that certain amounts standing as credits to the individual surplus accounts of stockholders on January 1, 1917, and January 1, 1918, represented dividends owing to its stockholders and not, as contended by the appellant, earned surplus which could properly be included in invested capital, be sustained, and, accordingly, that the appeal be denied.

II ('23)-2-722: I. T. 1582.\*

**Revenue Act of 1918.**

A corporation succeeded a partnership on January 1, 1918, and took over the assets and liabilities of the partnership at their book value. One of the items taken over was a reserve for taxes which represented the amount of the excess-profits tax due by the partnership and the amount of the income taxes due by the individual partners. The corporation, in opening its balance sheet on January 1, 1918, set up this reserve for taxes and claimed it as a part of its invested capital as of January 1, 1918.

Held, that the reserve for taxes when transferred from the partnership to the corporation represented borrowed capital in the possession of the corporation and that, in accordance with the provisions of section 326(b) of the Revenue Act of 1918, it could not be included in the invested capital of the corporation.

\*This Ruling No. 10 has been revoked by A. R. R. 2190 for which see herein at Sec. 326.—Art. 845.—8, Ruling No. 11.

**10**



**Law Section 325.—Terms Relating to Invested Capital (1918 Act—¶549 ante): (1921 Act—¶1028, post).**

**Article 815.—Inadmissible Assets (Reg. 45—¶743, ante): (Reg. 62—¶1183, post).**

1-19-116: O. 781.

**WAR FINANCE CORPORATION BONDS—"ADMISSIBLE ASSETS."**

Interest on an amount of bonds of the War Finance Corporation, the principal of which does not exceed in the aggregate \$5,000, is exempt from Federal income and excess-profits taxes. Corporate funds invested in such bonds are inadmissible assets to the extent that they are invested in bonds of a face value of not more than \$5,000, but funds of a corporation or an association invested in such bonds are admissible assets so far as they are invested in such bonds beyond a principal or face value of \$5,000.

Opinion is requested as to whether War Finance Corporation bonds are admissible or inadmissible assets of a corporation, within the meaning of section 325(a) of the Revenue Act of 1918. That subsection includes the provision that—

The term "inadmissible assets" means \* \* \* bonds and other obligations (other than obligations of the United States), the dividends or interest from which is not included in computing net income \* \* \*. The term "admissible assets" means all assets other than inadmissible assets, valued in accordance with the provision of subdivision (a) of section 326, section 330, and section 331.

Therefore, if funds which would otherwise be a part of the invested capital of a corporation are invested in War Finance Corporation bonds, no exclusion of funds so invested from invested capital will be necessary unless interest on such bonds is not included in computing net income. As shown below, the interest on so much of the principal of such bonds as exceeds \$5,000 is included in net income, and no funds so invested are to be considered inadmissible assets, by reason of being invested in such bonds, except as are invested in bonds having a face value of \$5,000, the interest on which is exempt.

This conclusion has the following basis:

War Finance Corporation bonds, held in excess of \$5,000 principal, are subject to surtaxes, although not to normal taxes, under the provisions of section 213(a) (4) Revenue Act of 1918—

In the case of bonds issued by the War Finance Corporation, the interest shall be exempt only if and to the extent provided in the respective Acts authorizing the issue thereof as amended and supplemented, and shall be excluded from gross income only if and to the extent it is wholly exempt from taxation to the taxpayer both under this title and under Title III.

That is, if, under the Acts authorizing the issuing of such bonds, they are not wholly exempt from taxation, such interest may not be excluded from gross income. These bonds are issued under the authority of the Act of April 5, 1918, which provides, in section 16—

That all such bonds shall be exempt, both as to principal and interest, from all taxation now or hereafter imposed by the United States \* \* \* except (a) estate or inheritance taxes and (b) graduated additional income taxes, commonly known as surtaxes, and excess profits and war profits taxes, now or hereafter imposed by the United States upon the income or profits of individuals, partnerships, corporations, or associations. The interest on the amount of such bonds the principal of which does not exceed in the aggregate \$5,000, owned by any individual, partnership, corporation, or association shall be exempt from the taxes referred to in clause (b).

Recognizing that a taxpayer may be required to include a certain amount of interest upon such bonds in gross income, section 216(b) of the Revenue Act of 1918 allows a *credit* for—

The amount received as interest upon obligations of the United States and bonds issued by the War Finance Corporation, which is included in gross income under section 213.

It is therefore held that interest on an amount of bonds of the War Finance Corporation, the principal of which does not exceed in the aggregate \$5,000, is exempt from Federal income and excess profits taxes. Corporate funds invested in such bonds are inadmissible assets to the extent that they are invested in bonds of a face value of not more than \$5,000, but funds of a corporation or an association invested in such bonds are admissible assets so far as they are invested in such bonds beyond a principal or face value of \$5,000.

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1-19-118: O. D. 81.

Federal reserve bank stock held by member banks is held to be an inadmissible asset in determining invested capital for excess profits tax purposes.

2

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(See 22-19-538; Section 326, Article 838.) Stock of foreign corporations deriving no income from sources within the United States.

3

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24-19-576: O. D. 305.

Inasmuch as dividends received by a domestic corporation from a foreign corporation deriving income from sources within the United States are allowable deductions in ascertaining the net income of the domestic corporation subject to tax, there could not be included in the invested capital of the domestic corporation receiving the dividends the amount of capital invested in the stock of the foreign corporation, or any part of the value thereof, except as outlined in article 817.

4

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21-21-1656: O. D. 929.

School warrants issued by a county of a State are held to be inadmissible assets in determining invested capital for excess profits tax purposes. [For modification see No. 3 at Sec. 325, Art. 818.—1.]

5



40-21-1857: O. D. 1057.

Inquiry if made whether 4 per cent bonds of the Government of the Philippine Islands are to be considered admissible or inadmissible assets in computing invested capital.

Section 325 (a) of the Revenue Act of 1918 provides that:

The term "inadmissible assets" means stocks, bonds and other obligations (other than obligations of the United States), the dividends or interest from which is not included in computing net income \* \* \*.

It is further provided in section 213(b) 4 of the Act that interest upon obligations issued by a possession of the United States is exempt from Federal income tax.

The bonds referred to are not obligations of the United States, but on the contrary are obligations of a possession of the United States. Accordingly, it is held, that 4 per cent bonds of the Government of the Philippine Islands are inadmissible assets within the meaning of section 325 (a) of the Revenue Act of 1918.

6

42-21-1875: O. D. 1069.

Since the income from Federal land bank bonds is tax free and since such bonds are not obligations of the United States, they are inadmissible assets within the meaning of section 325(a) of the Revenue Act of 1918, and should be so treated in computing the invested capital of a corporation.

7

(See I ('22)-4-48; Section 326, Article 831. Ruling No. 32.) Foreign corporate stock.

8

I-35-486: I. T. 1434

### Revenue Act of 1921.

The M. Company, a corporation with a fiscal year ending April 30, 1922, owned on May 1, 1921, y shares of the capital stock of the O Company which were carried as an asset at x dollars, representing their cost price.

In June, 1921, the O Company was dissolved. The general corporation laws of the State under which it was organized provide that a corporation continues in existence for three years after the date of its dissolution for the purpose of closing its business and distributing its assets, but not for the purpose of continuing its business, and that during this period the directors or governing body of the corporation are its trustees with power to settle its affairs, convey its property, pay its obligations, and divide its remaining assets among its stockholders.

Inquiry is made whether the undivided interest of the M Company in the liquidation of the assets of the O Company is an admissible asset from and after June, 1921, the date of the dissolution of the latter company.

Held, that the interest of the M Company in the assets of the dissolved corporation is represented by its stock in that corporation until such time as the assets of that corporation are actually distributed. It accordingly follows that any interest the M Company has in such assets prior to their distribution must be classed as an inadmissible asset.

9





**Law Section 325.—Terms relating to Invested Capital (1918 Act—¶548, ante): (1921 Act—¶1028, post).**

**Article 816.—Inadmissible assets: Government Bonds (Reg. 45—¶748, ante): (Reg. 62—¶1184, post).**

38-21-1836: O. D. 1044.

Inquiry is made whether bonds issued by Porto Rico and Hawaii are inadmissible assets.

The Revenue Act of 1918 provides, in part, as follows:

Section 325(a). That as used in this title the term "inadmissible assets" means stocks, bonds, and other obligations (other than obligations of the United States), the dividends or interest from which is not included in computing net income \* \* \*

It is further provided in paragraph 4, section 213(b), of the Act that interest upon obligations of a possession or territory of the United States is exempt from Federal taxation.

The foregoing provisions of law are here applicable. The bonds referred to are not obligations of the United States within the meaning of the parenthetical clause embodied in section 325(a) of the Act. Therefore, they fall squarely within the general language of that section and must be held to be inadmissible assets.

1





Law Section 325.—Terms Relating to Invested Capital (1918 Act—¶548 ante): (1921 Act—¶1028, post).

Article 817.—Inadmissible Assets: Partial Exception (Reg. 45—¶749 ante): (Reg. 62—¶1185, post).

Revenue Act of 1921.

I ('22)-51-649: I. T. 1536.

A corporation sold inadmissible assets consisting of stock at a profit and so brought itself within the provisions of article 817 of Regulations 62, to the effect that where the income derived from inadmissible assets consists in part of profit from the disposition thereof, a corresponding part of the capital invested in such assets shall be deemed an admissible asset.

The question was submitted as to whether under these conditions a corporation should deduct only the cost of the stock sold from its inadmissible assets for the period after the sale or whether it is permitted to deduct an amount equal to the amount which is added to admissibles as a result of the sale of the stock.

Held, that under the conditions stated, a corporation can decrease its inadmissibles only in an amount equal to the cost of the stock sold, *for the period after the sale*, as the value of both admissible and inadmissible assets employed in determining the invested capital of a corporation is represented by their cost of acquisition. In other words, when inadmissible assets are eliminated through sale, the total value of the inadmissibles is reduced by the cost price of the inadmissibles sold.

A corresponding increase equal to the cost of the inadmissibles sold should be made in admissibles effective only from the date of the sale, unless such proceeds are reinvested in admissibles. Any profit realized during the year on the sale of inadmissibles is a current profit and can not, under the provisions of the statute (section 326(3)), be included in invested capital until the succeeding year.





**Law Section 325.—Terms Relating to Invested Capital** (1918 Act—¶548, ante): (1921 Act—¶1028, post).

**Article 818.—Admissible Assets** (Reg. 45—¶750, ante): (Reg. 62—¶1186, post).

1-19-40: O. D. 28.

The computation of exempt interest from Liberty loan bonds will be based upon the full amount of bonds subscribed for and still owned. Interest upon obligations incurred to purchase or carry Liberty bonds issued after September 24, 1917, may be deducted from gross income.

In computing the amount of admissible assets for the purpose of determining the average percentage of inadmissible assets, the total cost of bonds subscribed for, whether fully paid for or not, may be included in admissible assets.

1

1-19-132: O. D. 93.

Conversion of certificates of indebtedness purchased by a corporation in 1918 into Victory loan notes of same value would not affect invested capital for purposes of war profits tax.

2

45-21-1915: O. D. 1096.

A bank is in possession of certain warrants drawn by a school district on the superintendent of schools for a county. These warrants are in the nature of drafts drawn in favor of the teachers in the public schools of a particular district. They were cashed by the bank as a matter of accommodation only for the teachers of the district. These warrants have been returned by the superintendent upon whom they were drawn with the notation thereon that no funds were available with which to meet these obligations. The warrants are carried by the bank without any remuneration in the shape of interest or discount.

Advice is requested as to whether these school warrants are admissible or inadmissible assets for the purpose of computing invested capital.

The definition of "inadmissible assets" as laid down in the different revenue Acts implies that stocks, bonds, and other obligations must be potentially interest-bearing or dividend-producing securities to come within the classification of an inadmissible asset. In the instant case it appears that the drafts, or school warrants, were cashed for the accommodation merely of the school teachers in whose favor they were drawn. No discount was received by and no interest is payable to the bank.

Held, that the noninterest bearing warrants drawn by the particular school district on the superintendent of schools for a county are admissible assets capable of being included in the invested capital of the bank in computing its assets. (O. D. 929, C. B. 4, p. 363, modified [see No. 5 at Sec. 325, Art. 815-2, herein].)

3





**Law Section 326.—Invested Capital (1918 Act—§555, ante): (1921 Act—§1035, post).**

**Article 831.—Meaning of Invested Capital (Reg. 45—§751, ante): (Reg. 62—§1187, post).**

**9-19-350: O. D. 202.**

The amount of taxes withheld at the source to be later paid over to the Government is not an asset of the withholding agent and must be eliminated entirely from the computation of invested capital.

1

**10-19-365: O. 872.**

**VALUATION OF INVESTED CAPITAL IN CASE OF CONSOLIDATION PRIOR TO MARCH 3, 1917.**

Where two corporations are engaged in different branches of the same business, and the certificate of incorporation of one of them is amended so as to change its name and increase its capital stock, which new stock is issued in exchange for the stock of the original companies, and this exchange is made prior to March 3, 1917, to determine the invested capital of the new organization there should be added to the invested capital, as defined by Section 207 (a), Revenue Act of 1917, of the company whose certificate has been awarded the fair value of the assets of the other company, this latter valuation to be made as of the date of the exchange of stock, and not of a later formal transfer of the tangible assets. (Revenue Act of 1917, secs. 201, 207, and 208.)

Opinion is requested as to the method of determining the amount of the invested capital of the Z Company for the year 1917.

In the year 1916 the M Company and the Y Company were engaged in the manufacture and sale of certain commodities. The M Company had a capitalization of 8x dollars; the Y Company of 5x dollars. It was decided to consolidate the business of the two companies, and to this end the certificate of incorporation of the M Company was in 1916 amended so as to change its name to "Z Company," and to increase its capital stock to 67x dollars. The stock of the Z Company was in that year issued to the stockholders of the M Company and of the Y Company. The assets of the Y Company were formally transferred to the Z Company by a bill of sale and by deed in 1917. A valuation was made in 1916 of the properties of the two companies which indicated that the net assets of the M Company were 12x dollars and of the Y Company 10x dollars. The Z Company seeks to have this valuation of the assets of the two companies, a total of 22x dollars, accepted as the basis of its invested capital for the year 1917.

It is assumed from the statement of facts that there was no change of corporate entity as between the M Company and Z Company, a theory which seems fair to the taxpayer by reason of the statement in the brief presented in its behalf that the certificate of incorporation of the M Company was amended, changing its name to "Z Company," and increasing its capital stock, etc.

The question presented is whether a "reorganization, consolidation, or change of ownership" under these facts was effected before or after March 3, 1917, within the meaning of section 208 of the Revenue Act of 1917; and if before March 3, 1917, how far the valuation of the assets of the two companies made in 1916 may be accepted as the basis of the invested capital of the Z Company for 1917.

The original M Company dealt in raw product, and the Y Company bought and manufactured it. It was, however, decided that the entire business could be better conducted under one management; and with this end in view the M Company increased its capital stock and issued it in ex-

change for the stock of the other two companies. The result was to vest complete control of the entire business in the Z Company, and to transfer to that company the control of the property of the Y Company as of the time when such merger so became legally effective, which was in 1916.

The Revenue Act of 1917 imposed a tax called the "War excess profits tax" upon "the net income of every corporation, partnership, or individual," in so far as such income exceeded certain percentages "of the invested capital for the taxable year" of the taxpayer (Revenue Act of 1917, sec. 201). "Invested capital" is defined as consisting of (1) actual cash paid in; (2) the cash value of tangible property paid in; and (3) surplus and undivided profits, exclusive of those earned in the taxable year (sec. 207). The statute further provides:

That in case of the reorganization, consolidation, or change of ownership of a trade or business after March 3, 1917, if an interest or control in such trade or business of 50 per cent or more remains in control of the same persons, corporation, associations, partnerships, or any of them, then in ascertaining the invested capital of the trade or business no asset transferred or received from the prior trade or business shall be allowed a greater value than would have been allowed under this title in computing the invested capital of such prior trade or business if such asset had not been so transferred or received, unless such asset was paid for specifically as such, in cash or tangible property, and then not to exceed the actual cash or actual cash value of the tangible property paid therefor at the time of such payment. (Sec. 202.)

The general rule indicated in the statute is that the value of invested capital is to be determined at the time when it is "paid in." It must now be decided when such payment is deemed to be made in cases where there has been a transfer or substitution of stock made in 1916, followed by a formal transfer of tangible assets in 1917.

Restating the rule of section 208, Revenue Act of 1917, for the determination of invested capital:

A. By express provision where there is a reorganization, consolidation, or change of ownership, (1) after March 3, 1917, and (2) 50 per cent or more of an interest or control remains in the same persons, corporations, associations, partnerships, or any of them, then as to assets transferred or received from the prior trade or business, no greater value shall be allowed therefor than if there had been no transfer, *unless* paid for in cash or tangible property.

B. In cases not covered by the provision quoted, that is, cases where the reorganization, consolidation, or change of ownership occurred before March 3, 1917, or after March 3, 1917, with less than 50 per cent remaining in the same control, the invested capital will be determined under the general rule. But where there is no change of identity of the absorbing organization, its prior assets must be valued under section 207 and not at the time of the reorganization, consolidation, or transfer, since there was no transfer of its assets at that time.

Applying the rule to the present case, the mere change of name by a nendment with an increase of stock did not involve a change of identity as to the M Company, and there could not have been therefore, a transfer of the assets of that organization within the meaning of the statute. As to the Y Company, there was a transfer of control, and under the facts this transfer was consummated before March 3, 1917, and its assets may therefore be valued as of the time of such transfer.

It will be necessary, therefore, in determining the invested capital of the Z Company to add to the valuation of the assets of the Y Company made in 1916 (assuming such a valuation to have been fair) such a sum as represents the invested capital of the M Company as defined by section 207(a) of the Revenue Act of 1917. The valuation of the assets of the latter company made in 1916 will have to be disregarded, and its assets valued on the basis that no change of ownership or control has occurred as to those assets. There was no transfer or receipt from "a prior trade or business" as to such assets.



11-19-389: T. B. M. 49.

It appears that the Y Company went into the hands of a receiver, the plant being worth, on the basis of cost less depreciation, approximately 8 $\times$  dollars. The creditors acquired the assets at a receiver's sale at a nominal figure in order to cover loans. They turned the business over to the Z Company, a new corporation formed for the purpose of taking over the property. The conditions of this latter sale were: (1) the Z Company was to supply  $\times$  dollars working capital; (2) the Z Company was to assume the unpaid liabilities of the Y Company and pay them off within a period of years; (3) the Z Company was to have the assets of the Y Company in return for meeting the liabilities.

Upon these conditions the Z Company was duly incorporated with a capital stock of  $\times$  dollars subscribed. It is claimed that the stockholders of the new corporation are the same as those of the defunct Y Company, and for that reason the new corporation requests to be permitted to set up an invested capital equal to that of the defunct corporation.

There is a difference of opinion as to whether the  $\times$  dollars actually paid in to the Z Company in return for their stock should be considered the total invested capital of the new corporation or whether the view should be taken that the new business is substantially a reorganization of the old, and, therefore, the invested capital be fixed upon that basis.

It would appear that the first of these views is correct. The Y Company went into the hands of a receiver and its property was sold to its creditors who were not the stockholders of the corporation. The title to this property passed absolutely to the purchasers, who were in nowise connected with the old corporation, except as creditors. The transaction was closed and completed as far as the old corporation and its stockholders were concerned.

The new corporation which was formed to take over the property could have been incorporated by stockholders of the former company or by entire strangers; the situation so far as it affected the creditors would have been the same. There may have been a community of interest between the stockholders of the old corporation and its creditors, and such interest would be a proving factor in the creation of the new corporation to salvage the property, but this would not change the legal status of the transaction. The new corporation having been formed, it took over the property which had been taken by the creditors in satisfaction of their claims on the following conditions:

They were to furnish  $\times$  dollars working capital, to raise which they sold stock; and they were to assume the unpaid liabilities of the old corporation in exchange for the property taken over by the banks.

The invested capital of the Z Company, therefore, would appear to be the  $\times$  dollars received for the stock sold. The value of the property received on condition of the assumption of the unpaid liabilities of the Y Company can not be included in invested capital because it is borrowed capital.

3

11-19-391: T. B. R. 40.

Reasonable commissions or other forms of compensation lawfully paid by a corporation for the sale of its capital stock not to be deducted in computing invested capital.

The opinion of the Advisory Tax Board has been asked as to whether commissions paid by a corporation for the sale of its capital stock are to be

deducted in computing invested capital. Upon this question section 326(a) states that invested capital means (1) "Actual cash bona fide paid in for stock or shares." \* \* \* These words signify the actual cash paid in to the corporation or to its duly authorized agents by the shareholders. Moreover, the treatment of this question and that of the deductibility of such commissions from gross income as ordinary and necessary expenses should be correlative. Under all Federal income tax laws corporations have been denied the right to deduct such commissions either as current expense or as a deferred charge to future years. As it is a fact that such commissions are "ordinarily" paid—and in the organization of many corporations "necessarily" paid—the position of the department with respect to the deductibility from income of this expense can rest only on the ground that it is essentially a capital expenditure, balanced by the acquisition of a permanent capital asset of equivalent worth.

Such payments must, like other compensation for personal service, be "reasonable" in amount. The payment of any unusual or disproportionate commission should, in the opinion of the Advisory Tax Board, be examined for the purpose of ascertaining whether the cash subscription has been "bona fide paid in" and whether under the circumstances of the particular case the commission was reasonable.

4

13-19-425: O. D. 246.

[ No taxable income accrues to a public utility corporation from a mere book entry charging construction account and crediting income account due to charging interest on the company's own funds used temporarily for construction purposes, as permitted under the Interstate Commerce Commission's classification; neither will the company be allowed to include in its assets such amount of interest charged to capital account for the purpose of determining invested capital.

5

13-19-431: O. D. 248.

Shares of stock distributed by a corporation to its employees in payment of services rendered, where the amount is not excessive, may be included in invested capital to the extent of the actual cash value of the services rendered.

6

24-19-577: O. D. 306.

[ Where bonds are exchanged for stock in the same corporation under the terms of a convertible trust deed, it will be presumed, for the purpose of computing invested capital, that the value of the bonds is equivalent to the value of the stock. The addition to invested capital would accordingly be the amount for which the bonds were originally sold.

7



24-19-578: O. D. 307.

A contract may be treated as tangible property when it relates to rights in tangible property to such an extent that its value arises chiefly therefrom, but it may not be treated as invested capital unless it is bona fide paid in for stock or shares in the corporation, in accordance with section 326(a) of the Revenue Act of 1918.

8

1-20-664: A. R. R. 10.

Held, that the M Company is entitled to include in invested capital only the amounts which have actually been paid to the company for the shares of stock issued and sold to officers and employees of the company under an installment agreement.

A meeting of the stockholders of the M Company authorized the setting aside of a sufficient number of shares of its common stock for the benefit of such employees as desired to purchase stock under prescribed conditions, and in pursuance of this authority a certain number of shares were so set aside, part of which were taken by an officer of the company and the balance of the stock by other employees. The officer's stock was charged to his personal account, which draws interest. The stock sold to the employees was subscribed for under agreement which permitted payment in cash, part cash and part deferred payments, or all deferred payments, subject to conditions that payment of subscriptions should be in weekly installments; that deferred payments should bear interest; and that the agreement might be canceled either upon request of the employee, failure to make payments, any attempt of the purchaser to sell his stock or agreement, or resignation or dismissal of the employee prior to the expiration of five years; in the event of any cancellation the employee to receive from the company the full amount of all payments with interest, and, dependent upon the time held more than one year, certain percentages of the difference between the subscription and market price of the stock. Dividends on the stock were to be credited to the subscriber's account as additional payments. In case of cancellation, however, the dividends were not to be credited and the subscriber is not to be charged with interest upon deferred payments.

Upon this statement of fact only so much of the subscription payments as have been actually received by the company may be recognized as invested capital from the date of such receipt. In the case of the officer's stock only so much of the stock as canceled a credit balance in his personal account or was actually paid for by him can be recognized.

9

14-20-838: A. R. R. 48.

#### RULING UNDER REVENUE ACT OF 1917.

Amounts added to invested capital in accordance with article 44 of Regulations 41 must be based on the amount of interest for the taxable year which is not allowed as a deduction, and not on amounts disallowed representing accrued interest for prior years.

10

17-20-881: A. R. M. 43.

National banks at times declare dividends which instead of being paid to stockholders are carried with the consent of the stockholders to a stockholders' liability account in the name of a trustee and the amount invested in deals not countenanced by the Comptroller of the Currency. Such stockholders' trustee account, however, is a liability to the individual stockholders, and the assets in which the reserve is invested are the property of the trustee for the stockholders. Therefore, from a technical viewpoint, no part thereof should be included in the invested capital of the bank even though it includes the income from the reserve in its gross income.

Since shares in the bank and in this reserve are on the same pro rata basis, and the stockholders are in fact an association, a consolidated return could be required of the bank and the association, the practical effect of which would be to include the amount of the reserve in the consolidated invested capital and the income from the reserve in the consolidated income. The Committee therefore recommends that the returns as made, including the stockholders' reserve accounts in the capital of the banks, and the income therefrom in the income of the banks, be allowed to stand.

11

28-20-1063: A. R. R. 167.

At the request of the taxpayer the Committee has reconsidered Recommendation 10, dealing with the question of whether or not an issue of stock sold to officers and employees of the M Company can be regarded as invested capital, the taxpayer urging that the conclusion of the Committee is not consistent with article 833 of Regulations 45, which holds that enforceable notes or other evidences of indebtedness, either interest bearing or noninterest bearing, of the subscriber received by a corporation upon a subscription for stock may be considered as tangible property and included in invested capital.

The Committee requested advice from the Solicitor as to whether or not the subscription agreements under which it was originally understood all of this stock was issued can be regarded as enforceable notes or other evidences of indebtedness within the meaning of this regulation, and is in receipt of a memorandum from him expressing the opinion that such stock agreements are not evidences of indebtedness and concurring in the conclusion reached by the Committee on Appeals as to these subscription agreements. It now appears, however, that the stock issued to the president was not issued in accordance with the conditions of the subscription agreements, but was a straight-out unconditional subscription charged to his account, bearing interest and subsequently converted into a note.

The Committee therefore recommends that so far as stock issued under subscription agreements is concerned the conclusion in A. R. R. 10 should stand, but that the stock issued to the president, not issued under subscription agreement, should be recognized as invested capital under the provisions of article 833.

12



31-20-1109: O. D. 618.

A domestic corporation has a branch office in London which keeps a separate set of books in English currency and renders a report at the end of the year as to the profits, making remittances to the home office from time to time as they accumulate in excess of the amount required for regular expenses.

In order to obtain the correct invested capital as at the beginning of the taxable year 1919, it is necessary to consolidate the balance sheet of the branch office with that of the home office. It is assumed that the net profits earned by the London branch during the year 1918 represent surplus; therefore in determining the amount of earned surplus attributable to the London branch, the amounts remitted by it to the home office should be taken into earned surplus at their value in American currency at the time when such remittances were made, and the balance of the net profits expressed in English currency should be converted into United States money at the rate of exchange as of the end of the taxable year, regardless of the fact that the profits may not have been remitted to the home office.

13

(See 31-20-1111; Section 327, Article 901.) Authority of Secretary of Treasury to fix tax and determine invested capital under section 210 of the Revenue Act of 1917.

14

41-20-1238: A. R. R. 268.

The Committee has had under consideration the appeal of the M Company, a Georgia corporation, from the audit of the company's returns for the years ended August 31, 1917, and August 31, 1918, resulting in additional assessments for those years.

In determining the invested capital of the corporation the field agent undertook to establish values as of 1898, on the theory that the company has been in continuous existence since that date. It appears, however, that the charter of the original corporation expired in 190-, which fact was not called to the attention of the officers or stockholders until 190-, at which time a new charter was secured. The question at issue, therefore, between the Unit and the taxpayer is whether the present company was in fact organized in 190-, or has been in continuous operation at least since 1898. As this was a question of law involving the scrutiny of the Georgia statutes, an opinion of the Solicitor upon the point involved was requested and the Committee is in receipt of an opinion from him as follows:

The Revenue Act of 1917, on the subject of invested capital of corporations provides as follows:

SEC. 207. That as used in this title, the term "invested capital" for any year means the average invested capital for the year, as defined and limited in this title, averaged monthly.

As used in this title "invested capital" does not include stocks, bonds (other than obligations of the United States), or other assets, the income from which is not subject to the tax imposed by this title nor money or other property borrowed, and means, subject to the above limitations:

(a) In the case of a corporation or partnership: (1) Actual cash paid in, (2) the actual cash value of tangible property paid in other than cash, for stocks or shares in such corporation or partnership, at the time of such payment (but in case such tangible property was paid in prior to January first, nineteen hundred and fourteen, the actual cash value of such property as of January first, nineteen hundred and fourteen, but in no case to exceed the



par value of the original stock or shares specifically issued therefor); and (3) paid in or earned surplus and undivided profits used or employed in the business, exclusive of undivided profits earned during the taxable year: *Provided*, That, (a) the actual cash value of patents and copyrights paid in for stock or shares in such corporation or partnership, at the time of such payment, shall be included as invested capital, but not to exceed the par value of such stock or shares at the time of such payment, and (b) the good will, trade-marks, trade brands, the franchise of the corporation or partnership, or other intangible property, shall be included as invested capital if the corporation or partnership made payment bona fide therefor specifically as such in cash or tangible property, the value of such good will, trade-mark, trade brand, franchise, or intangible property, not to exceed the actual cash or actual cash value of the tangible property paid therefor at the time of such payment; but good will, trade-marks, trade brands, franchise of a corporation or partnership, or other intangible property, bona fide purchased prior to March third, nineteen hundred and seventeen, for and with interests or shares in a partnership or for and with shares in the capital stock of a corporation (issued prior to March third, nineteen hundred and seventeen), in an amount not to exceed, on March third, nineteen hundred and seventeen, twenty per centum of the total interests or shares in the partnership or of the total shares of the capital stock of the corporation, shall be included in invested capital at a value not to exceed the actual cash value at the time of such purchase, and in case of issue of stock therefor not to exceed the par value of such stock.

Its terms, with some modifications not necessary to consider here, were extended and embodied in section 326 of the Revenue Act of 1918.

The only other provisions in either of said Acts relating to invested capital are sections 204 and 208 of the Revenue Act of 1917, and sections 330 and 331 of the Revenue Act of 1918. Sections 204 of the first Act and 330 of the latter Act both are limited in scope to the determination of invested capital for the prewar period and not for the taxable year, the former relating to reorganization "on or after January 2, 1913," and the latter to reorganization "after January 1, 1911" (see article 22, Regulations 41, and article 931, Regulations 45). While neither sections 208 of the former Act nor 331 of the latter Act have any application to reorganizations prior to March 3, 1917, since in express terms both relate to companies reorganized "after March 3, 1917," it is considered that the fair inference to be drawn from them is that assets, in case of reorganization prior to March 3, 1917, should be valued as of the date of transfer to the new corporation for the purpose of determining the invested capital of such corporation for the taxable year.

The question is now asked in connection with the appeal of the M Company, a Georgia corporation, whether said company is a continuation of a predecessor corporation, of the same name, whose charter actually expired in 190-, or is it, under the Georgia law, a new entity entitled to consider the value of assets paid in in 190-, in the determination of its invested capital. The Income Tax Unit has taken the position that there was no reorganization in 190-.

It appears that originally the M Company was organized in 187-, as a Georgia corporation, the life of its charter being 30 years. During this period it built up a large business, and acquired control of, and in 1898 absorbed, the property and business of several other corporations. The charter expired by limitation in 190-. There was no renewal of the old charter. In 190- the stockholders discovered that the corporation's charter had expired, and they then organized a new corporation under the laws of Georgia known as M Company; issued new shares of capital stock and paid for these shares by turning over to the new corporation "all of the property and assets and all of their interest in the M Company chartered in 187-." The new company was authorized "to ratify and accept as its corporation action all acts and deeds of the plants of the M Company which was chartered in 187-."

Park's Georgia Code, par. 2241, provides that "Every corporation is dissolved (1) by expiration of its charter." And par. 2245 thereof provides: "Upon the dissolution of a corporation for any cause all of the property and assets of every description belonging to the corporation shall constitute a fund, first for the payment of its debts and then for equal distribution among its members."

The Supreme Court of Georgia has held that, where a corporation's charter expired "the corporation was as dead as if it had never been chartered": (*Terry v. Merchants & P. Bk.*, 66 Ga. 177-8); that "after expiration of its charter, the corporation was no longer a legal entity" and a writ of error pending in the Supreme Court at the time of such expiration was dismissed, (*Logan v. W. & A. R. Co.*, 87 Ga. 533), as (there being then no longer any law under which it could exist) no valid judgment could be rendered against it (citing *Bertram v. Collins Mfg. Co.*, 69 Ga. 751, *Ran v. Union Paper Mill Co.*, 95 Ga. 208); and that the remedy provided by the Georgia Civil Code, par. 1886, when litigation was pending against a corporation at the time of expiration of its charter, is to have a receiver appointed to administer its assets under the direction of the court, its debts to be first paid, and the balance, if any, distributed among its shareholders, "as the action of its stockholders (who were separate and distinct from the corporation) owning all the stock, in continuing to



defend the suit after the expiration of the charter" did not operate to make the dead corporation a corporation de facto, or a corporation by estoppel, so as to authorize the plaintiffs to proceed to judgment against it. (*Venable v. Southern Granite Co.*, 135 Ga. 508-9).

The rules in question are not peculiar to Georgia, but are of general application and have been variously stated as follows:

On the termination of the corporate life, either by lapse of time or decree of court or otherwise, stockholders are at least the equitable owners of its assets, and it seems that, after the debts are paid, the legal title to real property vests in them as tenants in common, where the title of the corporation or its officers is not continued by statute or where the time during which the corporate life is extended by statute has expired, or where the term of the statutory trusteeship of the corporate officers has expired. (8 Fletcher Cyc. Corp. par. 5591, 5593 (37); *Stearns Coal and Lbr. Co. v. Van Winkle*, (Ky.) 221 Fed. 590.)

*Pewabic Min. Co. v. Mason*, 145 U. S. 349, 356, 36 L. Ed. 732.

When the charter expires, the corporation ceases to be a corporation either de jure or de facto and can thereafter exercise no corporate powers. (1 Fletcher Cyc. par. 285.)

A deed made by a corporation after its charter has expired is a nullity. (2 Cook on Corporations, par. 641, p. 1829).

Furthermore, "the stock cannot be transferred." (8 Fletcher Cyc. Corp. par. 5587). It is said that "a dissolution of a private corporation entirely changes the character of the property interest of the stockholders; it destroys their stock as such and under the modern equitable view substitutes the thing which their stock represented, that is, an interest in the corporate property." (7 R. C. L. par. 745).

Solicitor's Opinion 4 is consistent with the foregoing.

It is therefore held that for the purpose of determining invested capital for the taxable year a new and distinct corporation is created, where, upon the expiration of the corporate charter of the old organization, a new corporation is formed under a different charter, and property and assets of the old corporation are transferred by the old stockholders as legal owners thereof to the new corporation prior to March 3, 1917, in return for capital stock, and that the provisions of section 207, Revenue Act of 1917, and section 326, Revenue Act of 1918, embodying with some modifications its terms, are applicable in determining the invested capital of the corporation in question.

In this conclusion the Committee concurs, and it will be necessary for the Income Tax Unit to redetermine the invested capital paid in at the date of organization in 190-.

15

46-20-1307: A. R. R. 315

#### REVENUE ACT OF 1917.

The Committee has had under consideration the appeal of the M Company, from the action of the Income Tax Unit in denying the claim of the company for assessment under the provisions of section 209 for 1917, and assessing tax under the provisions of section 210.

The facts appear to be that this company was organized with a small amount of capital stock, none of which was paid up, and later it secured a lease to wharf property, no bonus being paid for the lease. The business of the company is the subletting of this leased property.

It is clear that the income of the company is derived chiefly from the possession of a capital asset which is not capital in name only, but a real tangible asset, to wit, its lease upon the wharf property.

The Committee is therefore of the opinion that the company can not be construed to have had no capital or only a nominal capital in the sense in which nominal capital has been construed by the courts, that is, capital in name only, and that the action of the Unit in denying assessment under section 209 and assessing tax under section 210 was proper. It therefore recommends that the action of the Unit be sustained.

16

47-20-1317: O. D. 734

In 1912 a piece of property was leased by the M Company for 50 years to A, who assigned his interest to the X Company, of which he was president. In 1913 the X Company erected a theater building on the property, which building became part of the reversion, and in 1914 leased the building and its interest in the assignment for a period of 20 years to the Z Company, which agreed to pay certain expenses as well as all taxes of both corporations (X Company and Z Company) and distribute remaining profits in accordance with certain terms agreed on, the X Company and the Z Company being in no manner affiliated and having no stock holdings in common.

Held, that the X Company and the Z Company should each file a separate return and compute their tax on their own invested capital. In computing the income and invested capital of the X Company the erection cost of the theater building should be allocated over the term of its lease under the assignment from A, such amounts being deducted each year as business expenses. The value of the building may be included in invested capital to the extent that it was erected out of the original paid-in capital or surplus of the X Company. Any part of its cost which was borne by borrowing money can not be so included. In arriving at the amount of invested capital as of the beginning of the taxable year, the sum of such prorated amounts which were or should have been deducted from the gross income of prior years, should be subtracted from the original cost of the building

17

7-21-1456: A. R. R. 384.

The Committee has had under consideration the appeal of the M Company from the action of the Income Tax Unit in reducing an improvement account carried on the corporation's books to cover the cost of improving a leased property under the terms of a 10-year lease which expired April, 1915, through depreciation charges allocated over the term of such lease, and disallowing as invested capital any portion of such account for the taxable year 1917 and subsequent years.

It appears from the records that the M Company, a corporation organized for the purpose of conducting a restaurant, leased certain portions of a building from A for a period of 10 years and 3 months. Under a memorandum of agreement which formed a part of the lease between A and the corporation, the latter obligated itself to pay a monthly rental of  $x$  dollars for the demised premises plus certain contingent charges and to expend  $30x$  dollars or more in making certain specified permanent improvements to such premises. The amount expended in making these improvements was carried to an improvement account on the books of the corporation, which account is still maintained. It is this account which the Unit has disallowed as invested capital for the year 1917 and subsequent years, from which action the taxpayer now appeals for the reason that no depreciation on the improvements has ever been claimed and for the further reason that the premises with respect to which the improvements were made are still in the possession of the taxpayer, the original lease having been renewed.

The taxpayer has filed with the Unit a certified copy of the memorandum of agreement which formed a part of the original lease dated November, 1904, together with certified copies of the agreements covering renewal leases dated March, 1915, and April, 1920.

This memorandum of agreement specifically provides that the improve-



ments therein provided for shall upon their installation by the lessee immediately become the property of the lessor. It contains no provision granting the lessee any right of renewal upon expiration of the lease and it is not shown nor claimed that the lessee had any such right under the lease itself. The lease was to run for a period of 10 years and 3 months beginning February, 1905, and ending April, 1915, on which latter date the lessee corporation was to surrender all right and title to the demised premises and the improvements which it was obligated to make. That the corporation did surrender all of such right and title is evidenced by the memorandum of agreement forming part of the renewal lease, dated March, 1915.

Article 109 of Regulations 45 as amended by Treasury Decision 3062, provides:

Where a leasehold is acquired for business purposes for a specified sum, the purchaser may take as a deduction in his return an aliquot part of such sum each year, based on the number of years the lease has to run. \* \* \* The cost borne by a lessee in erecting buildings or making permanent improvements on ground of which he is lessee is held to be a capital investment and not deductible as a business expense. In order to return to such taxpayer his investment of capital, an annual deduction may be made from gross income of an amount equal to the total cost of such improvements divided by the number of years remaining of the term of lease, and such deduction shall be in lieu of a deduction for depreciation. \* \* \*

Under the provisions of the above-quoted article the amount invested by the M Company in the said improvements, if paid for out of original capital or surplus, can be held to constitute invested capital for the taxable year during which expended, such invested capital to be reduced at the beginning of each subsequent year by an amount equal to the result obtained by dividing the total cost of such improvements by the number of years of the lease term. The lease under the terms of which the improvements were made expired in 1915, and subsequent to that year the taxpayer had no right or title under the lease to any asset which constituted a part of such improvements, not even the right of usage. The amount expended for the improvements and their installation may be considered as a bonus paid to secure the execution of the lease, or as additional rental for the leased premises to be charged off as expense ratably over the term of the lease. Whether or not such amount was so charged off, any right or title which the taxpayer ever possessed in the investment was exhausted upon termination of the original lease in April, 1915, and subsequent to that date it possessed nothing therein which can be said to constitute invested capital for the purpose of computing excess profits tax under the provisions of the Revenue Act of 1917 or 1918.

The Committee, therefore, recommends that the action of the Unit in disallowing as invested capital any portion of the amount expended for improvements by the M Company under the terms of the lease dated November, 1904, be sustained.

18

7-21-1453: O. D. 811.

No taxable income accrues to a railroad corporation from a mere book entry charging construction account and crediting income account due to charging rental on its equipment such as locomotives, cars, etc., when used temporarily by the corporation for its construction work, as permitted under the Interstate Commerce Commission's classification. Neither will the company be allowed to include in its assets such amount of rental charged to capital account for the purpose of determining invested capital.

19

8-21-1470: A. R. R. 393.

## REVENUE ACT OF 1917.

Held, that values claimed for "contracts, brands, and good will" can not be allowed as invested capital when it is not conclusively shown that such values represent paid-in capital of a partnership, and that in reorganization no greater value can be given to corporate assets than existed before reorganization, the interest in the corporation being substantially the same as that in the partnership.

The Committee has had under consideration the appeal of the M partnership, and the N corporation, from the action of the Income Tax Unit in disallowing certain items as invested capital.

The action of the Income Tax Unit in disallowing, in the taxable year 1917, 7x dollars as invested capital of the M partnership is explained in the following language:

This decrease is due to the disallowance of 7x dollars claimed as the value of contracts and good will not shown on the books of the partnership. No evidence has been submitted as to the value of these intangible assets, the methods of acquiring them, and the cost. (See Regulations 41, articles 57-60, 64.)

The action of the Income Tax Unit in disallowing as invested capital for the N corporation an item of 10x dollars is explained in the following language:

The amount at which these intangible assets were included in the invested capital of the M partnership, in its return for the five months' period ended May 31, 1917, has been excluded from the invested capital of the partnership in a letter addressed to it by this office. The corporation succeeded the partnership as of June 1, 1917. The excess profits tax return filed by the corporation shows that an interest of 50 per cent or more remained in control of the same persons. In such case no asset transferred from the partnership will be allowed to be included in the invested capital of the corporation, at a value greater than would have been allowed in computing the invested capital of the partnership if no transfer of assets had taken place, unless such asset is specifically paid for in cash or tangible property. (See Regulations 41, article 50.)

The facts on which the appeal has been taken may, therefore, be said to be definitely stated in the exceptions above quoted.

The partnership was of more than 40 years' standing and on June 1, 1917, its affairs were incorporated as the N Corporation with capital stock of 40x dollars. In the year 1917, just prior to this reorganization, there was set up on the books of the partnership an item of 7x dollars for "contracts, brands, and good will," but in the reorganization by incorporation the said account "contracts, brands, and good will" was set up on the books of the corporation as of the value of 10x dollars. It is contended that two contracts, recorded in this accounting, were worth at least 10x dollars, but it is noted, these contracts dated as far back as the year 1908. It is further contended that as the result of an examination and audit of the books of the M partnership, for the years 1908 to 1912, inclusive, the average net earnings on invested capital of said partnership were more than 52 per cent. It is noted however, that at December 31, 1916, the financial statement of the partnership showed a deficit of  $\frac{1}{4}$ x dollars. It is not in evidence that the value of "contracts, brands, and good will," either in the amount claimed as set up on the partnership books or in the amount claimed as set up on the corporation books, was actually paid into the partnership or corporation.

Article 42 of Regulations 41 provides, in part, as follows:

The basis, or starting point, in the computation of invested capital is found in the amount of cash and other property paid in, the original values of such other property being determined in accordance with the rules laid down in these regulations. \* \* \* If value appreciation of a kind not subject to income tax (other than that allowed under article 55) has been taken up in the accounts, a deduction must be made in respect of such appreciation so taken up.



This Committee, in its Recommendation 17 published in Bulletin 3-20, said, in part, as follows:

The fact remains, however, that the law expressly provides what may be regarded as the invested capital of a corporation or partnership, and that is, as affects the question now at issue, the amount of cash or tangible property paid in to the corporation or partnership for stock or *shares*, the share evidently referring to the member's interest in the *paid-in capital* of the partnership.

The law and the decisions issued thereon by the Department have consistently stated that the basis or starting point in the computation of invested capital is the amount of cash or other property actually paid in, the original values of such other property being determined in accordance with the statute and regulations.

It is contended that the partnership was one of long standing and that the right to include this additional capital is entirely justified from figures and detailed statements of earnings as reflected by two contracts alone. The Committee can not concur in this contention. It can not recognize going concern value or appreciation growing out of the development and expansion of a business. There is no justification in the law or in the regulations for doing so. Furthermore, it has been conclusively pointed out by the Income Tax Unit, that under article 50 of Regulations 41:

If an interest or control in such trade or business of 50 per cent or more remains in control of the same persons, corporations, associations, partnerships, or any of them, then in ascertaining the invested capital of the trade or business no asset transferred or received from the prior trade or business shall be allowed a greater value than would have been allowed under these regulations in computing the invested capital of such prior trade or business if such asset had not been so transferred or received, unless such asset was paid for specifically as such, in cash or tangible property, and then not to exceed the actual cash or actual cash value of the tangible property paid therefor at the time of such payment.

In this article no distinction is made between tangible and intangible assets so transferred.

The Committee accordingly recommends that the action of the Income Tax Unit in disallowing these items as invested capital of the partnership and of the corporation be sustained.

20

8-21-1471: A. R. R. 396.  
REVENUE ACT OF 1917.

Held, that the value of certain patents for which stock of the M Company was issued must be measured by the cash consideration paid therefor by certain incorporators of the company just prior to incorporation:

The Committee has had under consideration the appeal of the M Company from the action of the Income Tax Unit in disallowing as invested capital the par value of shares of stock of the said corporation issued specifically for patents at date of incorporation.

The M Company was incorporated in 1914, with capital common stock of 250x dollars. The articles of incorporation read, in part, as follows:

The amount of the capital stock of said corporation shall be 250x dollars divided into 25y shares.

It appears that in September, 1913, A assigned an undivided one-half interest in two patents to B in consideration of  $1\frac{1}{2}x$  dollars in cash, and in June, 1914, A assigned his remaining one-half interest in said patents to C, D, E, and F, in consideration of 5x dollars cash and in further consideration of said assignees assuming the liability of A in all the debts and outstanding

obligations of the A Company, a partnership, which debts and obligations amounted to  $3\frac{1}{3}x$  dollars.

The Income Tax Unit, based on the report of an examining revenue agent, allowed  $6\frac{1}{2}x$  dollars as the value of the patents acquired for 225x dollars of the total issue of capital stock of the corporation organized immediately thereafter. In addition thereto, there was allowed as invested capital 11x dollars, the said amount being the cash paid in at par (\$100) for 1 1-10y shares. There was also allowed as invested capital  $1\frac{1}{2}x$  dollars, the actual cost of patents subsequently acquired, making a total invested capital of 19x dollars.

Because the income of the corporation was disproportionate to the amount of invested capital, the tax was subsequently adjusted under section 210 of the Revenue Act.

The taxpayer contends that the full par value, namely, 225x dollars, should be allowed for the two patents first mentioned, and that on this basis of invested capital the tax should be assessed under section 207 of the Revenue Act. As above stated, the Income Tax Unit has rested its decision on the purchase price of the patents, as evidenced by sale when acquired by certain individuals, five of whom subsequently became incorporators of the M Company.

No evidence has been submitted by the taxpayer to show the value of similar patents, if indeed such evidence could be produced, but the record shows that for the fractional part of the year 1914 (the year in which the company was incorporated) there was a profit of  $\frac{1}{3}x$  dollars from operations; in 1915 a profit of 27x dollars; in 1916 a profit of 44x dollars, and in 1917 a profit of 43x dollars. In this latter year the corporation claimed a depreciation based on the life of the patents which, if disallowed, would leave a net income of 70x dollars. It is also a matter of record that the 1 1-10y shares of stock were sold at par to about 25 individual subscribers in various proportions and an affidavit has been submitted by a broker who says that he has been engaged in the brokerage business for several years and that in the course of his business he has sold a good deal of the stock of the M Company during the three years just prior to May, 1919, at a price uniformly something near par, the sales ranging between \$85 and \$105 per share.

The Committee has given careful consideration to the above facts, but it can not fail to recognize that the A Company, a partnership, which conveyed the patents immediately prior to the organization of the M Company, a corporation, to the principal incorporators for a cash consideration definitely known, was not successful in developing these patents. What efforts were made to do so are not recorded in the files before the Committee, but the fact is that after final sale of the patent rights to a group of successful business men there was immediately put forth an active, progressive, commercial plan which gave general recognition to the practical use of the patents. It was this development of an idea in a systematic, corporate way without the necessity of large financial investment by any one of the incorporators of the M Company that gave substantial return to the stockholders. The Revenue Act does not recognize as *paid-in capital* a value rising from development of an idea after incorporation. It may be said this value is reflected in the *earned surplus* and, as such, it is a part of the invested capital of the corporation.

That a cash value of 225x dollars for the patents at time of incorporation of the M Company was not recognized by the incorporators is indicated by failure of such incorporators to return as individual taxable income the difference between this amount, pro rata, and the cash purchase price.



On these conclusions the Committee recommends that the action of the Income Tax Unit in fixing a value of the patents by the cash consideration paid therefor just prior to incorporation of the M Company and the subsequent assessment of taxes by the Unit under Section 210 of the Revenue Act of 1917 be approved.

21

8-21-1468: O. D. 821.

Section 1764, Wisconsin Statutes (1915) provides that the corporate existence of a dissolved corporation shall be continued for the purpose of liquidating its assets and winding up its affairs. It is held, therefore, that profit resulting from the sale of assets of a Wisconsin corporation in process of liquidation is subject to income and excess profits taxes in the same manner as profits derived from the active operation of the corporation.

In such a case the invested capital to be used as a basis in determining the excess profits credit is arrived at in the same manner as invested capital of an active corporation, making due allowance for any amount of capital assets which have been liquidated and returned to the stockholders.

Section 1764, Wisconsin Statutes (1915) provides:

\* \* \* and when any corporation shall become so dissolved the directors or managers of the affairs of such corporation at the time of its dissolution, by whatever name they may be known, shall, subject to the power of any court of competent jurisdiction to make, in any case, a different provision, continue to act as such during said term and shall be deemed the legal administrators of such corporation with full power to settle its affairs, etc.

Therefore, the responsibility for filing appropriate returns for the corporation and paying taxes shown thereby to be due devolves upon the trustees in liquidation of such other legal administrators as have charge of the property and affairs of the corporation during the period of liquidation. They must make returns of income for such corporation in the same manner and form as an active corporation. Conversely, they are not required to file returns as fiduciaries.

22

9-21-1487: A. R. R. 390.

The Committee has had under consideration the appeal of the M Company, a corporation, from the action of the Income Tax Unit in adjusting the company's tax returns for the years 1917 and 1918. The points at issue are the valuation of the old plant of the company as of February 14, 1917; depreciation actually sustained in the years 1917 and 1918, and a proper compensation for officers.

As of January 1, 1917, the N Company had outstanding paid-in capital stock of 10x dollars, all of which was owned by A and B, but the buildings and the land on which the buildings were located were owned individually by A and B. During the month of January there was a reorganization. The name of the company was changed to the M Company and the capital stock was increased to 40x dollars and issued in equal amounts to A and B. The stock of the N Company was retired, and the additional capital of 30x dollars was written up on the books as good will. Under date of February 14, 1917, A and B, without further consideration, turned over to the corporation the buildings, which they individually owned, and the original bookkeeping entry was adjusted, crediting good will with 15x dollars to the debit of real estate and buildings. The revenue agent, who examined the books of

the corporation, reduced the value of these buildings from  $15x$  dollars to  $6x$  dollars, and this deduction affected both depreciation and invested capital. This examination was made in 1919 and he based his reduction of this asset on a statement made by A that he would accept  $4x$  dollars in cash for the property, and on a statement made by B that they were holding the property at  $8x$  dollars on a trade for some other real estate. The taxpayer, in taking exception to the valuation determined by these statements, has submitted two appraisals, one by C, which places a going concern value on the property as of February 11, 1917, of  $15x$  dollars, and the other by D, which places the appraisal on a cost basis less depreciation as of December 22, 1919, at  $10x$  dollars, of which valuation  $9x$  dollars is for the buildings and  $x$  dollars is for the land. In a conference held with the Income Tax Unit the valuation of  $6x$  dollars placed by the revenue agent was increased by the Unit to  $8x$  dollars.

The Committee is of the opinion that the going concern value, as determined by the appraisal by C, is more or less speculative and that the value adopted by the revenue agent is without substantial foundation. The additional value allowed by the Unit appears to be more or less arbitrary in an effort to arrive at a compromise adjustment which, however, was not accepted by the taxpayer. Accordingly, the Committee is of the opinion that it can not fail to respect the appraised value (by D) of  $10x$  dollars, plus the depreciation on the buildings from February 14, 1917, to December 22, 1919, as most correctly reflecting the sound value at date of transfer.

This adjustment of value will change the amount of depreciation as adjusted by the revenue agent, but in addition thereto the taxpayer, through public accountants of good standing, has submitted a very elaborate schedule of depreciation on all other property values, basing the same on inventory of the values taken by the owners of the property in March, 1913. These were depreciated values but the taxpayer applied these rates of depreciation annually on reduced values. The revenue agent made no changes in this basis but accepted the taxpayer's figures as reasonable. The public accountants, however, have consistently, in the compilation of their statement, applied the rates annually on the appraised value or on cost when acquired subsequent to appraisal and it is understood that no substantial change has been made in the rates except in the year 1917 when, on account of the plant running at double capacity, an accelerated rate on machinery, based on 40 per cent of the normal rate, was used. The Committee has carefully analyzed this schedule of depreciation prepared by the public accountants and is of the opinion that it should govern in disposing of the question of depreciation, subject, however, to the valuation as above approved for the buildings taken over in February, 1917.

For three years prior to 1917, A and B, sole owners of the stock of the corporation, and its principal officers, were each paid  $x$  dollars annual salary. In November, 1917, by resolution of the board of directors, this salary was increased to a total salaried expense of  $5x$  dollars per annum. Of this aggregate amount for the two officers, the revenue agent disallowed  $2x$  dollars prorated for 1917 and for the year 1918, making the salary of each  $1\frac{1}{2}x$  dollars per annum instead of  $2\frac{1}{2}x$  dollars. This disallowance of  $2x$  dollars was reduced by the Income Tax Unit, in conference with the taxpayer, to  $x$  dollars, which gave each of the officers of the company an annual salary of  $2x$  dollars per year as against  $2\frac{1}{2}x$  dollars per year as claimed in the returns and supported by the action of the directors of the company.

The average yearly sales of the company from 1912 to 1916, inclusive, amounted to  $45x$  dollars. In the year 1916 the sales were  $52x$  dollars; in



1917, 72x dollars; in 1918, 82x dollars. In the latter year the net income of the company was less than in 1917, but this is explained by the retirement of substantial parts of the old plant and to moving into the new plant. However, a salary deduction of 4x dollars for the taxable year is in fair comparison with that of similar industries and on this basis it was allowed by the Unit.

Summing up, the Committee is of the opinion that value of buildings acquired in February, 1914, should be accepted on basis of recognized appraised value; that depreciation should be adjusted on this value and on the appraised value as of March, 1913, of other units of equipment and at established rates to which the taxpayer conforms in his depreciation schedule and that the action of the Income Tax Unit be sustained in allowing compensation of the two principal officers at the rate of 4x dollars per annum.

24

23-21-1680: Ct. D. 12.

[This "ruling" consists, merely, of the United States Supreme Court decision in the La Belle Iron Works case reported in full beginning at ¶889 herein.—The Corporation Trust Company.]

24

27-21-1719: A. R. M. 134.

REVENUE ACT OF 1917.

Held, that the M Company should be allowed the full amount of  $3\frac{1}{3}x$  dollars expended by it in cash prior to the year 1909 and capitalized as a part of the cost of developing certain intangible assets which it had acquired for stock and cash.

The Committee has had under consideration the request of the Income Tax Unit for an expression of opinion whether an expenditure of  $3\frac{1}{3}x$  dollars by the M Company for advertising prior to the year 1909 can be capitalized and allowed as invested capital for the taxable year 1917.

The M Company was incorporated in 189-, at which time it acquired a trade-mark for a consideration of 2x dollars cash. This purchase included a contract granting to the corporation the exclusive right to sell this preparation. In 189- it acquired certain other trade-marks for 3x dollars, issuing therefor capital stock of the company in this amount. In another year prior to 1909, it acquired several other trade-marks and formulae, issuing therefor 2x dollars in capital stock.

In 1905, by action of the board of directors of the company, the sum of x dollars, expended for advertising, was capitalized by being charged to trade-marks, formulae, etc. In 1906 the board of directors ordered x dollars eliminated from expense and capitalized. In December, 1906, by order of the board of directors, following an advertising campaign, a credit of  $\frac{1}{3}x$  dollars was carried to profit and loss (thus decreasing expenses and increasing net income) and same was capitalized by charging it to trade-marks, formulae, etc. In April, 1906, by action of the board of directors, a further expenditure of x dollars, made as of a previous year for advertising, was capitalized and charged to trade-marks, formulae, etc. The items for advertising, capitalized as above indicated, aggregate  $3\frac{1}{3}x$  dollars and the corporation now contends that the capital stock issued against this intangible

should be allowed in full as invested capital since the intangible was acquired for cash.

It is noted that all of these transactions occurred prior to the year 1909 and the case, therefore, as presented, is not unlike that on which the Committee passed its opinion under Recommendation 115 (not published in bulletin service), March 27, 1920. In that opinion it was said:

The Committee is not of the opinion that article 841 of Regulations 45 should be applied in the instant case. This regulation seems obviously to have been drawn for the purpose of preventing the inclusion in surplus or invested capital, for the taxable year 1918, of amounts charged to expenses prior thereto, when the intent was to evade taxation. But such intent in this case is not clear, nor can it even be inferred. Indeed, the facts absolutely prohibit such an inference, for the reason that the transaction by which this restoration to invested capital was accomplished was made effective on the first day of March, 1909, thus conclusively demonstrating the intention of the directors in regard to these expenditures, many years before the income and excess-profits tax law was placed upon the statute books.

In the opinion of the Committee, the regulation would be effective to prevent the restoration to invested capital in 1918 of amounts previously charged to expenses, but a careful reading of the regulation renders it exceedingly doubtful that it is subject to so broad a construction that it can, by any possibility, be applied to transactions accomplished and completed before that year. Attention is particularly directed to the last sentence of the regulation quoted above: "An election of this sort which was made concurrently with the transaction can not now be revised, and amended returns in respect thereof can not be accepted."

There is no intent on the part of the corporation now to revise an action taken years ago and no attempt has been made to file amended returns.

The Committee believes that this reasoning is strengthened by the following quotation from Article 843 of Regulations 45:

\* \* \* Where a corporation has charged to current expenses the cost of developing or protecting patents, no amount in respect thereof expended since January 1, 1909, can be restored in computing invested capital. In respect of expenditures made before January 1, 1909, a corporation now seeking to restore them must be prepared to show to the satisfaction of the Commissioner that all such items are proper capital expenditures.

While the opinion just quoted was applicable to the invested capital of a corporation for the taxable year 1918, there is no reason why the same principle should not be applied in determining the invested capital of the M Company for the taxable year 1917.

The Committee accordingly is of the opinion that the M Company should be allowed the full amount of  $3\frac{1}{2}x$  dollars, expended by it in cash prior to the year 1909 and capitalized, as a part of the cost of developing certain intangible assets which it had acquired for stock and cash.



32-21-1765: O. D. 991.

In 1920 a corporation increased its capital stock by issuing  $y$  additional shares of stock of a par value of  $x$  dollars per share. Each stockholder registered on the corporation's book at the close of business March —, 1920, was given the right to subscribe for one new share of stock for each two shares of old stock held by him on that date upon payment of  $2\frac{1}{2}x$  dollars per share, payable as follows:  $x$  dollars on May —, 1920,  $\frac{3}{4}x$  dollars on June —, 1920, and  $\frac{3}{4}x$  dollars on July —, 1920.

The company was to pay interest at the rate of 6 per cent per annum on such payments from the date each payment was made. Interest on all payments ceased August —, 1920, the date when the certificates were exchanged for the stock of the company. Stockholders desiring to pay in full at one time were privileged to do so on May —, 1920, but at no other time. The right to subscribe for stock expired on May —, 1920.

The question raised is whether the payments made prior to August —, 1920, can be treated as invested capital from the date on which they were received, or whether the invested capital may be increased only as of August —, 1920, the date on which the subscribers received their paid-up stock certificates.

Held, that the subscription payments received by the company may be properly treated as invested capital from the date on which they were received, and that the so-called interest paid to the subscribers on the installment payments from the date of each payment to August —, 1920, was, in fact, distribution of profits from surplus, and accordingly is not a deductible expense.

26

34-21-1787: O. D. 1007.

The books of a corporation were kept according to the single-entry system of bookkeeping, and its income and expenses were recorded on a cash receipts and disbursements basis. At the end of the taxable year 1919 a statement of assets and liabilities was prepared in connection with its Federal income and profits tax return. There were reported on the statement as assets the cash balance, the fixed and intangible assets, and also such accounts receivable as were on the memorandum records, but the income from which had not been taken into the books. The statement also showed on the liability side the amount of outstanding capital stock and also bills payable and accounts payable which were shown by the memorandum records, but the expenses for which had not been taken into the books.

Held, that the corporation can not report its income on a cash receipts and disbursements basis and compute its invested capital on an accrual basis. As the corporation's income is reported on a cash receipts and disbursements basis, accrued items can not be taken into consideration in computing its invested capital.

27

41-21-1862: O. D. 1061.

The principles contained in office decision 246 [No. 5 of Sec. 326. Art. 831.—4, herein.] are applicable under the Revenue Acts of 1916 and 1917.

28

49-21-1968: O. D. 1131.

It is the purpose of Treasury Decision 3220, in cases in which returns were filed contrary to section 207 of the Revenue Act of 1917 and section 326 of the Revenue Act of 1918, and the regulations issued thereunder, to have amended returns filed and any tax shown to be due thereon paid immediately, rather than to wait until the returns are finally reached in the regular course of audit in this office. The fact that there may be no further tax shown to be due on the amended returns in such cases is not sufficient to waive the filing of such returns.

29

I ('22)-1-14: I. T. 1155.

**Revenue Act of 1918.**

A corporation which is a "dealer in securities" within the meaning of article 1585 of Regulations 45 is not entitled to include in invested capital amounts invested in inadmissible assets, even though such assets are held as merchandise, except under conditions entitling it to the benefits of article 817 of Regulations 45.

30

I ('22)-2-25: I. T. 1163

**Revenue Acts of 1917 and 1918.**

Where for the year 1918 returns were filed and the war and excess profits tax paid was equal to 50 per cent of the net income, relief having been requested under sections 327 and 328 of the Revenue Act of 1918, or where for the year 1917 returns were filed under article 64 of Regulations 41, and full disclosure was made on the return of the inclusion therein of restorations to invested capital, amended return will not be required under T. D. 3220 (Bul. 37-21, p. 18) and T. D. 3243 (Bul. 48-21, p. 18). However, in cases where returns were filed under article 64 of Regulations 41 and no disclosure was made of the inclusion therein of restorations to invested capital, the requirements of T. D. 3220 and T. D. 3243 must be complied with.

31

I ('22)-4-48: I. T. 1177.

**Revenue Acts of 1917 and 1918.**

A domestic corporation, prior to March 3, 1917, transferred tangible property to a foreign corporation in exchange for over 50 per cent of the stock of the foreign corporation. Subsequent to March 3, 1917, the domestic corporation transferred certain other tangible property to another foreign corporation in exchange for over 50 per cent of the stock of the foreign corporation. Neither foreign corporation had income from sources within the United States.

Two questions are raised: (1) At what value may the domestic corporation include in its invested capital the stock of the foreign corporations under the Revenue Acts of 1917 and 1918? (2) In case the foreign corporate stock is recognized as invested capital only to the amount of the original cost of the property transferred, is it possible for any taxable income to accrue from the exchange?

These two inquiries may be considered together, as the same principles of law are involved. Section 208 of the Revenue Act of 1917 and section



331 of the Revenue Act of 1918, relating to a determination of the invested capital of a corporation exchanging its stock for tangible property, are not here applicable.

A foreign corporation having no income from United States sources would be tax exempt, and consequently its stock in the hands of a United States corporation would constitute an admissible asset. The exchange being of one kind of property for another kind, a profit or loss would normally arise, as the values would ordinarily not be exactly equal. An exchange of one capital asset for another would not, however, affect the invested capital of the United States corporation, unless in the case of a loss the current earnings were insufficient to meet such loss, in which case the true or earned surplus would have to be reduced; but in no case should the original paid-in capital or surplus be reduced on account of such loss, it not being permissible to reduce those items except upon partial or total liquidation.

Accordingly, it is held that the stock should be included in invested capital at the same value that the tangible property exchanged therefor would have been entitled to be included therein had no exchange taken place, regardless of when the transaction was consummated, and that taxable income or deductible loss might result from the transaction.

A domestic corporation owning stock of a foreign corporation should treat such stock as an inadmissible for the entire taxable year if at any time during such taxable year the foreign corporation had income from sources within the United States.

32

I('22)-6-82: I. T. 1201.

#### Revenue Acts of 1917 and 1918.

In determining invested capital for 1917 and subsequent years the taxpayer, an insurance company, used security valuations demanded and furnished by the insurance department of the State and, as required, filed a copy of its State report with this office.

Owing to its inability to furnish cost values of securities, advice was requested as to what action should be taken in order to comply with the provisions of Treasury Decision 3220 ('865 herein).

Held, that as the invested capital of insurance companies is adjusted by this office on the basis of cost from annual statements rendered to the insurance departments at the close of the previous year, it will not be necessary for insurance companies to file amended returns under the provisions of Treasury Decision 3220, if in the original returns securities or real estate have been valued on the basis of book or market as reported to the insurance department of the State

33

I('22)-8-108: I. T. 1218.

#### Revenue Acts of 1917 and 1918

The taxpayer company for several years prior to 1917 followed the consistent practice of adding taxes paid upon its real estate to the capital account representing such real estate on its books, and did not charge such taxes to expense, and did not make any deduction on account of such taxes in preparing its income tax returns for the years 1909 to 1916, inclusive.

During 1917 and subsequent years such real estate taxes were charged to expense and were not capitalized.

Held, that taxes on real estate are not properly chargeable to the real estate capital account for income and profits tax purposes, but are deductible as expenses for the year in which paid or accrued, dependent on how the taxpayer's books are kept. The taxpayer should eliminate from its invested capital the taxes formerly included in its real estate capital account, and the excess profits tax for 1917 and subsequent years should be recomputed.

34

I('22)—9-122: I. T. 1226

#### Revenue Act of 1917.

The terms current liabilities and temporary indebtedness, as used in article 44 of Regulations 41, which reads as follows:

The term "money or other property borrowed" as used in section 207 and these regulations includes not only cash or other borrowed property, which can be identified as such, but current liabilities and temporary indebtedness of all kinds, and any permanent indebtedness upon which the taxpayer is entitled to an interest deduction in computing net income. A corporation which, under the income tax law, is allowed to take only a part of the entire interest paid upon its indebtedness, may include in its invested capital such a proportion of its permanent indebtedness as the amount of interest upon such indebtedness which the corporation is not allowed to deduct is of the total amount of interest paid upon such indebtedness during the taxable year—

are intended to apply to liabilities chargeable against profits as distinguished from indebtedness incurred for the purpose of raising capital. Such permanent indebtedness amounts to a capital investment. Therefore, while the amount of interest on current liabilities deductible against income for the year is included within the language of the Act limiting the amount of interest deductible as well as interest on permanent indebtedness, article 44 did not operate to make current liabilities includable in invested capital, since from their nature they were not includable. It does permit a portion of the permanent indebtedness to be included where the interest on such permanent indebtedness is not deductible by reason of the limitation contained in section 12 of the Revenue Act of 1916 as amended by the Revenue Act of 1917.

In case a corporation had no permanent indebtedness but the amount of deductible interest was limited, no amount may be included in invested capital on account of such limitation. But a corporation which has both temporary and permanent indebtedness may assume to the extent of its permanent indebtedness that any interest which it is not allowed to deduct has been paid upon such permanent indebtedness.

The term permanent indebtedness is intended to cover money and property borrowed to be invested in the business.

If the indebtedness is of a permanent character the term or nature of the particular obligation by which the indebtedness is evidenced at any time is not conclusive. Thus, notes used to acquire borrowed capital which the corporation plans to continue to use after the maturity of the notes (meeting the matured notes with the proceeds of other borrowings) may be regarded as permanent indebtedness within the meaning of article 44 of Regulations 41. So also in the case of bonds, mortgages, or other obligations about to fall due. If in the regular financial procedure of the corporation these obligations will be met by the proceeds of other indebtedness, such obligations may be treated as a part of the permanent indebtedness.

The computation of additions to invested capital must be based on per-



manent indebtedness as distinguished from temporary indebtedness and current liabilities. In case the permanent indebtedness is increased, diminished, or liquidated during the tax period the average amount of such indebtedness for the period should be used in applying the provisions of article 44 of Regulations 41.

35

I('22)—13—190: I. T. 1260

#### Revenue Act of 1921.

Where a business owned by an individual is organized as a corporation under the provisions of section 229 of the Revenue Act of 1921, investments owned by the individual but not connected with his business can not be included in invested capital unless and until they are paid in and become assets of the corporation.

36

I('22)—26—375: I. T. 1374

#### Revenue Acts of 1918 and 1921.

In 1919 a group of men contributed 300x dollars in cash to a common fund which was placed in the hands of a trustee for the purpose of acquiring royalty contracts under certain patents which they desired to obtain for a proposed corporation which had not been incorporated at that time. Later this trustee obtained assignments of these various contracts and rights for a total consideration of 300x dollars in cash. A corporation was then formed and after its organization the trustee offered to transfer to the corporation all of the contract rights which he had acquired in consideration of the issuance of 300y par-value shares of its stock to the parties who were the original contributors of the 300x dollars cash with which he acquired these rights. This offer was accepted by the corporation and the agreement was carried into effect.

Held, that the facts stated show this to be a case where a corporation acquired intangible property for stock, and that as such it must be governed by the provisions of section 326(a)5 of the Revenue Acts of 1918 and 1921, and that the invested capital of the corporation represented by the patent rights is subject to the 25 per cent limitation imposed by that section. This is true, although the individuals who advanced the money for the purchase of the contract rights were the same individuals who became the stockholders of the corporation through a transfer of these rights in exchange for the corporation's stock.

37

I ('22)-28-405: I. T. 1391.

## Revenue Acts of 1918 and 1921.

The procedure set forth in Office Decision 623 (C. B. 3, p. 105) to be followed by concerns which report profits from installment sales as realized at dates of payments does not contemplate adjustments of the capital investment account either for payments on such contracts or for the final transfer of title. It does, however, require the elimination from inventory of goods sold on installment contracts. No distinction is made between sales on condition, in which title remains in the seller, sales which involve transfer of title subject to a lien and sales in which title passes but is revested in the vendor by means of a chattel mortgage. (Article 42, Regulations 45.)

The following example illustrates the effect of this procedure:

Inventory, January 1, 1921.....	\$100,000	
Installment sales, 1921.....	100,000	
Cash receipts from installments sales contracts, 1921.....	50,000	
Gross profit percentage.....	50%	
(a) Installment sales contract (1921).....	\$100,000	
Goods sold (at cost).....		50,000
Unrealized gross profit on installment sales contracts (1921).....		50,000
(b) Cash.....	50,000	
Installment sales contracts (1921).....		50,000
(c) Unrealized gross profit on installment sales contracts (1921).....	25,000	
Realized gross profits on installment sales contracts.....		25,000

It will be seen that installment sales contracts (1921) less unrealized gross profits at the time of the sale equals the value of goods sold and is substituted therefor. The installment sales contract account is decreased and replaced to the extent of cash payments thereon. At the same time that proportion of unrealized gross profits on installment sales contracts which represents the gain included in cash receipts is transferred to realized profits on installment sales contracts.

In the balance sheet as at December 31, 1921, the opening inventory of \$100,000 is replaced by cash, \$50,000; installment sales contracts less unrealized profits, \$25,000; inventory, \$50,000. These items reflect the original value plus a realized gain of \$25,000.

38

(See A. R. R. 988; sec. 331, art. 941 [ruling No. 17].) Increase of invested capital of a corporation by appreciation in value of its assets upon change of ownership which was nominal and not substantial.

39



I (22)-33-459: I. T. 1420.

**Revenue Acts of 1917, 1918, and 1921.**

In 1885 certain persons organized a corporation and a certificate of incorporation was issued to them. In 1911, in pursuance of the advice of an attorney, the company was reorganized in order to cure defects in its original organization, and the powers of the corporation were broadened, its capital increased, and its existence made perpetual. In 1914 the name of the corporation was changed and thereupon all of the assets standing in the then name of the corporation were transferred by a deed having a covenant of warranty to the corporation designated by its new corporate name.

Held, that the copy of the original charter of the corporation and of the renewed charter, and the other evidence submitted by the taxpayer, disclose that the amendmen of its charter and the subsequent change in its name did not create a new corporation, nor cause any change in its existing corporate organization. The invested capital of the corporation, accordingly, must be computed in the same manner as though the invested capital of the corporation originally formed in 1885 was being determined. The values of the assets on hand at the beginning of 1917 and later years must be determined by their values at the time of their original acquisition, as limited and defined by the Revenue Acts applicable to the taxable years involved, and their values at the date of the amendment of the corporation's charter or at the date of its change of name can not be considered for such purpose.

40

I (22)-49-628: I. T. 1523.

**Revenue Acts of 1918 and 1921.**

If a corporation acquires patents or other intangible assets for cash, such assets may be reflected in its invested capital at an amount equal to the amount of the cash actually paid for them, but if they are acquired for stock they can be reflected in invested capital only to an amount not in excess of 25 per cent of the capital stock of the corporation outstanding at the beginning of the taxable year. This limitation prevents intangibles purchased with stock from being included at their full cost only when such cost exceeds in amount 25 per cent of the par value of the total stock or shares of the corporation outstanding at the beginning of the taxable year. No expenditures of capital made by a corporation in organization or advertising can be used to increase the value at which the patents owned by it may be reflected in its invested capital, as this amount is fixed by the cost of the acquisition of the patents, subject to the 25 per cent limitation in case they were acquired for stock.

In the case of the reorganization of a corporation which does not involve a change in corporate identity, no change takes place in the value at which its intangibles acquired for cash are to be included in its invested capital, and no change takes place in this value with reference to patents or other intangibles acquired for stock, unless the reorganization involves a change in the amount of the corporation's capital stock which is sufficient to cause a different result when the 25 per cent limitation is applied.

In case the reorganization involves a change of corporate identity through which the assets of an existing corporation are acquired by a successor, the rule applicable to the original corporation will apply in determining the amount at which the intangible assets acquired by the new corporation may be included in its invested capital. If such assets are acquired for cash, they

may be included in computing invested capital at their cost price, while if they are acquired for stock they may be included to an amount not in excess of the par value of the stock issued for the same, subject to the 25 per cent limitation, as explained above.

The statements in the preceding paragraph, however, are subject to requirements of sections 331 of the Revenue Acts of 1918 and 1921.

From the foregoing it is apparent that the reorganization of a corporation does not necessarily cause any decrease in its capital represented by patents or other intangibles.

41

II ('23)-2-723: A. R. R. 1300.

Section 2, Revenue Act of 1913; Section 12(a), Revenue Act of 1916; Section 207, Revenue Act of 1917; Sections 234 and 326, Revenue Act of 1918.

Recommended, in the appeal of the M Company, that no deduction from gross income be allowed in any year under review for amortization of the contract for services of A nor for redeemed theater passes; that in the computation of invested capital for 1917 and 1918 the options and leases acquired for common stock be treated as tangible property and allowed at a value equal to the par value of the stock issued therefor, and that the  $10x$  dollars common stock issued for services to be rendered be allowed only to the extent that services valued at  $x$  dollars per year have been rendered.

The Committee has had under consideration the appeal of the M Company from the action of the Income Tax Unit in adjusting its returns for the years 1915 to 1918, inclusive, partly in accordance with the revenue agents' report dated May—, 1920, and in assessing additional taxes for the year 1918.

The appellant company was incorporated under the laws of the State of Z in —, 1914, with a capital stock of  $53.3x$  dollars divided into  $w$  shares of 8 per cent cumulative preferred stock of the par value of  $y$  dollars per share and  $w$  shares of common stock of the same par value, for the purpose of erecting and operating a theater. The preferred stock was issued to incorporators, other than A, for cash and the common stock was issued to A for certain options to lease and leases on real estate for prepaid services and for cash.

During the years 1912 to 1914, inclusive, A purchased certain leases on real estate and secured options to purchase and options to lease other properties. After the organization of the M Company these properties were offered to the company for  $13.3x$  dollars of its common stock. The board of directors, by formal resolution, stated that the properties had been ascertained, adjudged, and declared to be of a fair value of  $13.3x$  dollars, that the acquisition of the same was necessary for the business of the company to carry out its contemplated object, and authorized the issuance to A of  $13.3x$  dollars full-paid common stock therefor.

The Committee has carefully examined all of the evidence submitted by the appellant to substantiate the value placed upon these properties by the vendor and the vendee and has reached the conclusion that such value has been fully established.

In the same agreement, under the terms of which the above properties were sold to the company, A agreed to direct and manage the new theater for a period of 10 years without salary for a consideration of  $10x$  dollars of the common stock. He also agreed to purchase the remaining  $3.3x$  dollars common stock for cash. These transactions were consummated and the stock was so issued.



In the audit of the case the Unit regarded the transactions under which the 23.3x dollars of common stock was issued (13.3x dollars for the leases and options and 10x dollars for prepaid services) as the purchase by the company of a contract, and in the computation of invested capital treated such contract as intangible property subject to the limitations prescribed by the Revenue Acts of 1917 and 1918. In the computation of net income the Unit allowed as a deduction in each of the years 1915 to 1918, inclusive, amortization at the rate of x dollars per year for that portion of the contract representing prepaid services, thereby treating the thing acquired by the company in consideration of the 10x dollars common stock as a deferred asset to be written off over the 10-year life of the contract.

In the opinion of the Committee such action was clearly in error. The resolution of the board of directors as recorded in the minutes clearly shows that the 13.3x dollars of common stock was issued for leases and options to lease certain definitely described real estate and such property is not subject to the limitations prescribed for intangibles. The 10x dollars of common stock was issued for services to be rendered in the future; that is, for an executory contract for the performance of services in the future. Courts have held that such a contract is not property within the requirements of the laws which provide that corporations shall not issue stock or bonds except for money, labor done, or property actually received. (See 125 N. Y. S., 572; 134 Fed., 341; 150 N. Y. S., 668.) Section 207 of the Revenue Act of 1917 and section 326 of the Revenue Act of 1918 provide for the inclusion in invested capital of the value of property paid in for stock or shares. The thing paid in must be property, and accordingly a promise to perform services in the future may not be taken into invested capital at any value. It appears reasonable, however, to treat A's agreement to serve the company as manager for a period of 10 years next ensuing, in consideration of the issue of common stock, as of the nature of a purchase of stock on the installment plan, and under this theory only that portion of the stock as represented services actually performed at the end of each year could be admitted as invested capital for the year next ensuing.

Nothing has been submitted to show specifically the fair value of the services rendered by A, although the earnings of the company for the first six years of its existence indicate that under his management it prospered exceedingly. The Committee feels, however, that the value per year fixed by agreement between A and the company is more controlling of the fair value of such services than the subsequent prosperity of the company. It is therefore recommended that x dollars be allowed in the computation of invested capital for each year's services as performed, and that in computing net income, no deduction be allowed in any year for amortization of the contract to render services.

Subsequent to the audit of the case by the Unit the Company requested permission to deduct from income for each year as a business expense of the year a percentage of the face value of redeemed theater passes issued for window display of posters, billboards, write-up in newspapers, personal services and rental of "props" for various acts. It is contended that the issue of passes for the purposes above named and the consequent necessity for the redemption of such passes with seats results in a loss to the company, because it frequently happens that prospective patrons must be advised that no seats are available, when the seats are desired are occupied by pass holders.

The Income Tax Unit takes the position that if gross income is to be charged with the value of the seats given for passes it should be credited with the same value when the passes are presented for redemption. The company admits that when the passes are redeemed income should be credited,

but not for the full value of the seats, inasmuch as the passes are restricted and because of such restrictions can not be sold by the persons to whom issued for more than one-half price. In brief, the company requests that it be permitted to charge gross income with the full value of the seats occupied by pass holders and to credit income with only one-half of such value. The Committee finds no merit in such a contention. If the passes are worth the full value of a seat when given in payment for privileges, services, etc., it appears to be entirely unreasonable to assume that they have a less value when presented for redemption.

In view of the foregoing, it is recommended, in the appeal of the M Company, that no deduction from gross income be allowed in any year under review for amortization of the contract for services of A nor for redeemed theater passes; that in the computation of invested capital for 1917 and 1918 the options and leases acquired for common stock be treated as tangible property and allowed at a value equal to the par value of the stock issued therefor; and that the  $10x$  dollars common stock issued for services to be rendered be allowed only to the extent that services valued at  $x$  dollars per year have been rendered.

42

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 II ('23)-15-992: A. R. R. 2766.

### Revenue Acts of 1917 and 1918.

A bank refused to receive partnership funds for deposit and the partners deposited a part of the surplus each year in the names of the partners, A and B. Upon incorporation all the partnership assets were transferred to the corporation, and these individuals owned over 95 per cent of the stock. The accounts of the corporation contain no record of these deposits or accrued interest.

The deposits do not constitute assets of the corporation even though it received credit on the basis of them and the cost of liquidating the corporation was paid out of them.

The Committee has carefully considered the appeal of the M Company from the action of the Income Tax Unit in excluding from invested capital the sum of  $34.33x$  dollars, which represented cash in savings banks placed in the individual names of A and B instead of the corporate name of the M Company. In 1920 the Unit requested the advice of the Committee upon the issue involved, which was given in A. R. M. 109 (not published) under date of February —, 1921. Appellant has filed additional evidence and contends that the ruling contained in A. R. M. 109 should be reversed.

The N. Company, a copartnership, has engaged in the business of jobbers and commission merchants, and on February —, 1914, was incorporated under the name of the M Company, with an authorized capital of  $37.5x$  dollars. It took over the business of the partnership and all its assets. The appellant corporation in filing its return for the year 1917 set up on its books as an asset as of December 31, 1916, a good-will item of  $20.19x$  dollars. A revenue agent investigated the books of the corporation and reported that this was an arbitrary figure placed on the balance sheet in order to effect a balance of the books. The taxpayer could not explain why this was done, and accordingly this amount was disallowed as a capital item entirely. Amended returns were filed showing  $34.33x$  dollars, deposited in savings banks in the individual names of A and B, and a request was made to include this sum in the computation of appellant's invested capital. No claim



was made, however, in the amended returns for the good-will item aforementioned. Upon the request of the Unit for advice on the subjects involving the good-will item, 20.19x dollars was disallowed as a capital item. The money in bank, 34.33x dollars, was also excluded from invested capital on the ground that it was not the property of the corporation.

It appears that the savings bank of the city of S as a matter of policy refused to receive partnership funds for deposit, and because of such refusal the partners deposited a part of the surplus each year in the names of the partners, A and B. After incorporation these individuals owned over 95 per cent of the stock of the appellant company, and from February 1, 1914, to the date of liquidation of the appellant company in 1920 the amounts in the savings banks credited to the above-named individuals were continuously increased. The accounts of the corporation, however, contain no record of these deposits or interest accrued thereon.

There is of record evidence showing that A and B wrote letters to mercantile houses stating that the amounts in the R Bank credited to their accounts were the property of the appellant company; that such statements were given to mercantile agencies; that, on May —, 1918, the appellant company borrowed from the R Bank the sum of 10x dollars, and later, on November —, 1918, the sum of 10x dollars, on the credit established by the savings deposits credited to A and B; that in 1920, when the business was liquidated, the cost of liquidation was paid out of these deposits, and the balance distributed among the stockholders.

The Committee is unable to agree with the appellant's contention that the deposits in savings banks in the names of A and B constituted assets of the corporation. As a matter of law, the corporation had no title to these deposits, and the fact that it may have received credit upon the basis of such deposits is immaterial. There is no basis in the law or regulations for the inclusion of these deposits in the statutory invested capital of the corporation.

The Committee therefore recommends that the action of the Income Tax Unit be sustained and the appeal denied.

\* \* \* \* \*

KINGMAN BREWSTER,  
*Chairman Committee on Appeals and Review.*

II ('23)-34-1209: I. T. 1848.

### Revenue Acts of 1917, 1918, and 1921.

A corporation organized in 1917 used only borrowed money in acquiring its assets. It was not entitled to any statutory invested capital at the date of its organization.

For the purpose of computing depreciation the property should be valued at its cost price, in spite of the fact that it was purchased with borrowed money. In ascertaining the amount upon which depreciation is to be computed the purchase price should be allocated between depreciable and nondepreciable assets.

In 1917 a corporation, organized that year, acquired a mill from another corporation. The purchaser obtained a portion of the money necessary for the purpose by borrowing on the security of a deed of trust; it obtained another portion by borrowing from a third corporation, and gave its notes to the vendor corporation for the balance of the agreed price. The purchaser then issued capital stock to its own incorporators in an amount greatly in excess of the purchase price of the property. This stock was watered stock, as the corporation received no assets in exchange for the same. The property was appraised during 1918 at an amount in excess of the purchase price but

below the amount of the capital stock issued. The corporation thereupon balanced the amount of its liabilities, represented by its capital stock and notes payable, by assets representing the plant at its appraised value and an item designated as intangible property representing the excess of its liabilities over the appraised value of its plant.

Held, as the purchaser used only borrowed money in acquiring its assets it was not entitled to any statutory invested capital at the date of its organization. This fact, however, did not bring it within section 209 of the Revenue Act of 1917, as it employed a substantial amount of borrowed capital in conducting its business. The appraisal of its assets in 1918 at a figure in excess of the amount paid for them did not entitle the taxpayer to any paid-in surplus or to any addition to invested capital.

For the purpose of computing depreciation the property should be valued at its cost price, in spite of the fact that it was purchased with borrowed money. In ascertaining the amount upon which depreciation is to be computed the purchase price should be allocated between depreciable and non-depreciable assets.

44

II(23)-39-1272: I. T. 1888.

#### Revenue Act of 1918.

There was a completely new corporation formed prior to March 3, 1917, which succeeded to the assets and rights of two corporations organized under the laws of two other States and dissolved after the consolidation. The capital stock of the new corporation was very much larger than that of either of the predecessor corporations and larger than the total of the stock of the predecessor corporations held by individual stockholders. The purpose of the reorganization was to effect a change of character enabling a distribution of dividends. The change of ownership was made. The new corporation would have a right on its application to assert values as of the date of reorganization.

Held, that there was a distinct new taxable entity both for the purpose of invested capital and income and that the stock of a fourth corporation may be included in invested capital only at the value which may be established as of the date of reorganization. Any deductible loss on account of the stock of this fourth corporation must be determined upon the basis of its value as of the date of reorganization.

A consolidation of the M Companies, a corporation organized under the laws of the State of X, and the N Company, a corporation organized under the laws of the State of Y, was effected in 1916 by the organization of a new corporation under the laws of the State of Z, which succeeded to their assets. The merger was accomplished by exchange of the capital stock of the O corporation of Z for the capital stock of both the M Companies and the N Company, and the subsequent dissolution of the latter companies by the O corporation as sole stockholder, the assets of the dissolved companies being received by the new corporation on cancellation or retirement of the stock of the dissolved companies.

The outstanding stock of the M Companies at the time of merger was 50x dollars and the outstanding stock of the N Company at the time of merger was 34x dollars, whereof 18x dollars was held by the M Companies. The O corporation issued in exchange therefor 70x dollars par value of its stock. The new corporation, therefore, issued 4x dollars par value of stock in excess of the par value of stock of the predecessors outstanding in the hands of stockholders, other than the holdings of parent in subsidiary. This 4x dollars represented an adjustment as to preferred stockholdings in the predecessor companies partly on account of unpaid accrued dividends



and partly on account of an adjustment of values as to holdings of the companies' preferred stock. The total issue of stock of the new corporation was 14x dollars less than the total outstanding stock, inclusive of holdings of the parent in the subsidiary, of the predecessors. It appears that the reorganization was effected with the purpose principally of transferring the business to a new corporation under the laws of the State of Z in order that there might be greater freedom in the administration of the affairs of the business, particularly in the distribution of dividends, it appearing that the predecessor corporations were unable to pay dividends under the laws of the States of their organization on account of the impairment of their capital.

One of the predecessor corporations, N Company, had at some time prior to March 1, 1913, acquired stock in the P Company at a cost of 10x dollars. The P Company failed in 1914. It appears that the revenue agent was unable to determine that the P Company stock had any value at the date of consolidation and formation of the new corporation.

The corporation now claims that its invested capital should be determined on the basis of the cost to the two predecessor merged companies—that is, on the theory of continuity of the taxable entity or entities, notwithstanding that there was a dissolution of the predecessor corporations and formation of a new corporation in 1916.

In the case of reorganization where a new corporation has been substituted for an old corporation as the owner of the assets, except in the case of reorganization after March 3, 1917, where 50 per cent of the interest or control in the business or property remains the same, it is the general rule that the assets acquired by the new corporation shall be valued for the purposes of invested capital of the new corporation at the cost of the new corporation of the value of the assets acquired for stock at the time so acquired, and the advantage of this rule has been almost universally claimed by such reorganized corporations and has been applied in the computation of invested capital.

In this case, reorganization was not a mere change of domicile, since the stock of the new corporation was nearly double that of either old corporation, and the stockholders had new rights represented by new interests, and the new corporation was not subject to the inability to declare dividends as were the old corporations on account of the impairment of their capital and the inability to declare dividends thereby involved under the laws of the States of their organization.

It appears that the courts have, in the construction of Federal taxation laws, uniformly observed the distinct entity of a corporation and have not departed from the strict observance of a legal entity and separate taxability of each legal entity whenever there are in fact different legal entities, without reference, however, to the situation where such distinctions under the consolidation requirements are in the years of consolidation for tax to be disregarded.

The courts in *Eisner v. Macomber* (252 U. S., 189); *Meischke-Smith et al. v. Wardell* (286 Fed., 785); *United States v. Phellis* (T. D. 3270; C. B. 5, p. 37); *United States v. Rockefeller* (T. D. 3271) consistently applied the separate legal entity doctrine for the purpose of taxation.

In *United States v. Phellis* (T. D. 3270), where there was a reorganization and a new and larger corporation was substituted for the old, the court said:

\* \* \* In the light of all this, we can not regard the new company as virtually identical with the old, but must treat it as a substantial corporate body with its own separate identity, and its stockholders as having property rights

and interests materially different from those incident to ownership of stock in the old company.

The findings show that it was intended to be established as such, and that it was so created in fact and in law. There is nothing to warrant us in treating this separateness as imaginary, unless the identity of the body of stockholders and the transfer in solido of the manufacturing business and assets from the old company to the new necessarily have that effect. But the identity of the stockholders was but a temporary condition, subject to change at any moment at the option of any individual. As to the assets, the very fact of their transfer from one company to the other evidenced the actual separateness of the two companies.

The facts in this case are not similar to the facts at issue in A. R. R. 16 [Sec. 331, Art. 941.—1, Ruling No. 3], where there was a mere change of domicile. In view of all the facts of this case—that there was a completely new corporation formed in another State; that this new corporation succeeded to the assets and rights of two corporations organized under the laws of two other states; that the capital stock of the new corporation was very much larger than that of either of the predecessor corporations; that the capital stock of the new corporation was larger than the total of the stock of the predecessor corporations held by individual stockholders; that the purpose of reorganization was to effect a change of character enabling distribution of dividends—and in consideration also of the fact that the change of ownership was, therefore, such that the Bureau could not refuse the corporation on its application the right to assert values as of the date of reorganization for invested capital, it is held that there was in this case, at the time of the reorganization, the creation of a distinct new taxable entity both for the purposes of invested capital and income, and that therefore the stock of the P Company may be included in capital only at the value which may be established as of the date of reorganization and that any loss deducted in 1919 or any period after the date of reorganization must be determined upon the basis of the value of the P Company stock as of the date of reorganization. Sol. Op. 4 [Sec. 330, Art. 931.—1, Ruling No. 1] indicates that the holding herein is in harmony with the principles heretofore established.



Law Section 326.—Invested Capital (1918 Act—¶555, ante): (1921 Act—¶1035, post).

Article 833.—Tangible Property Paid in: Evidence of Indebtedness (Reg. 45—¶754, ante): (Reg. 62—¶1189, post).

22-20-980: S. 1391,

WAR PROFITS AND EXCESS PROFITS TAX—SECTIONS 325 AND 326,  
REVENUE ACT OF 1918. INVESTED CAPITAL.

Notes to be paid for only out of earnings accruing on stock for which they are ostensibly given should not be included in invested capital.

Section 325 (a) of the Revenue Act of 1918 provides that the term "invested capital" as used in the Act shall include notes. The by-laws of the M Company, a corporation organized under the laws of the State of Oregon, provide that no one shall be allowed to hold stock in the corporation who is not actually identified with and devoting his entire time and talents to the interests of the company, and it is the practice in that company when the services of a desirable person are secured to pay him a nominal salary and issue him shares of stock, for which his enforceable note is taken, the note being paid out of the profits accruing on the stock. The questions are as follows:

- (a) Do the laws of the State of Oregon allow issuance of capital stock for (enforceable) notes?
- (b) Can the amount of (enforceable) notes outstanding at the beginning of the year be included in invested capital?
- (c) Are the notes, given under the conditions named above, enforceable within the meaning of the law as enacted by Congress, and interpreted by the Commissioner to govern invested capital computations?

(a) It is not found that the laws of Oregon specifically recognize the issuance of stock for notes. They do, however, recognize issuance of stock without cash payment. They also recognize the issuance of stock for property, real or personal. Section 6694, Lord's Oregon Laws, provides:

Every corporation organized under this chapter shall keep a stock book in such manner as to show intelligibly the original stockholders, their respective shares, the amount paid, and the amount due thereon, if any \* \* \*

See also sections 6696 and 6707. If stock may be issued for property or without any payment, it seems clear that it may be issued for notes.

(b) Section 326 (a) of the Revenue Act of 1918 provides:

That as used in this title the term "invested capital" for any year means \* \* \*

(a) Actual cash value of tangible property other than cash, bona fide paid in for stock or shares at the time of such payment \* \* \*

Under this language it is not sufficient that notes are enforceable. They must be bona fide paid in. This point is discussed more fully in dealing with the next question.

(c) While nothing is found in the statement submitted to show that the notes in question are not legally enforceable, it does not necessarily follow that they are such notes as were contemplated by the framers of the Act as to be treated as invested capital. The law limits includable tangible property to that bona fide paid in. The notes in question are taken from employees, and it is stated by the president of the concern that it is "clearly understood that the notes given as evidence of stock ownership were to be paid wholly from the earnings of such stock and in the event that such employee-stockholder severed his connection with the company, such stock immediately would revert to the company, and the net earnings accrued on same would be immediately paid to him." Notes given under such condi-

tions are not bona fide paid in within the intent of the statute. As indicated by the regulations, article 833, Congress doubtless had in mind notes given in absolute and unqualified payment, notes which are practically equivalent to cash and might be sold for cash, which, in other words, work an increase of the assets of the concern. Here the notes are given only as "evidence of ownership" and no collection thereon is to be made from the employee until he receives or is credited with dividends on the stock for which the notes are ostensibly given. The notes, therefore, add nothing to the resources of the company. There is no increase in its invested capital until it is earned by the company. It would not be consistent with the understanding between the company and the employee to raise money by discounting the notes. Conceivably, the concern might achieve an increase of working capital by borrowing on the notes, but by the express terms of the Act, borrowed money is not admissible. Section 325 (a), section 326 (b). If such arrangements should be recognized as working an increase of invested capital, invested capital might, at least to the extent of the amount authorized by the company's charter, be increased practically at will. The conclusion reached is that a note to be paid for only out of earnings accruing on the stock for which it is ostensibly given should not be included in invested capital.

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10-21-1502: A. R. R. 413

Held, that good will in a corporation can not be allowed as invested capital under a claim that a price paid to stockholders by certain individuals was in excess of corporate book value of the stock. Good will must be acquired by direct purchase; it can not be determined by a collateral transaction.

The Committee has had under consideration the appeal of the M Company from the action of the Income Tax Unit in denying an item of good will of 10x dollars, claimed by the corporation to have been purchased with cash in 1911.

In 1876, A established a restaurant business and continued to operate the same as sole owner until his death in February, 1901. After his death, the business was carried on under the terms of his will by certain trustees. The trust estate continued for a period of 10 years, but on account of contracts expiring in 1905 and 1906 requiring a renewal for a period of 10 years, thus extending beyond the trust, it was necessary to create some entity capable of contract. A corporation with nominal capital of 4x dollars was accordingly formed and, in keeping with the terms of the will, the stock was issued in the name of the trustees. All contracts were renewed in the name of A, except for certain business directly pertaining to the State of Y, which business was contracted in the name of the N Company, another corporation capitalized at 4x dollars to meet statutory requirements of the State of Y. It is the contention of the taxpayer that the business of the corporation was conducted substantially as a personal service corporation and that all bank accounts were continued in the name of A.

In 1911, in accordance with the provisions of the will, the trust terminated and it was necessary to make distribution to the six heirs. Under this distribution the widow was entitled to 50 per cent of the estate and the balance was to be equally divided among five children. In order to make satisfactory distribution, the trustees sold the stock which they held for 60x dollars in cash and this amount was distributed to the heirs in the proportions above indicated. It appears that the book value of the stock was only 50x dollars and in order to measure the value of the stock by the cash consideration that was paid to the trustees, there was set up an asset of good will in the



amount of 10x dollars. This amount was subsequently, in the next succeeding five years, charged off at 2x dollars per annum.

In submitting the case for consideration by this Committee, B, president of the corporation, made affidavit in the following statement:

\* \* \* in other words, there was paid in cash for 4x dollars par value of M Company stock (with which went the 4x dollars par value N Company stock), 50x dollars being the book value of the furniture, fixtures, supplies, etc., and also 10x dollars for good will, or a total of 60x dollars which was contributed as follows: B, 38%; C, 20%; D, 20%; E, 15%; F, 7% and the stock was distributed accordingly.

Of these purchasers, only B and D were beneficiaries under the will, each receiving 10 per cent of the estate. Subsequent to consideration of the case by the Committee but prior to the final approval by the Committee, B submitted an additional affidavit in which the statement is made that—

As representative of the corporation, I had agreed to sell to myself and the other four individuals, the entire assets of the business of the M Company and the N Company. This was my intention; it was what we did.

The matter of the transfer of this property to the new organization was never discussed, but what we were purchasing was minutely understood by all of us; that is to say, we were purchasing all of the assets of the business. No thought was given to the purchase of stock, and no thought was given as to the method of transfer.

This subsequent affidavit seems to have no material bearing on the case, since it is a matter of record that the corporation known as the M Company was never liquidated. A corporation can not sell its assets and at the same time retain them. The M Company is doing business to-day under the charter issued at date of organization, namely, June, 1906, and the same amount of capital stock is outstanding, namely, 4x dollars. It was, of course, necessary to cancel the certificates of stock that were outstanding at the time of purchase by B and his associates because, as above suggested, the certificates had to be issued in different proportions of ownership. The transaction, accordingly, was between stockholders and individuals, and, under such circumstances, where value in excess of corporate book value is the consideration for the acquisition of stock, the exchange value does not measure the value of assets of the corporation. It is admitted by the taxpayer that the 10x dollars in cash, in excess of the book value of the assets and forming a part of the cash consideration of 60x dollars was never paid in to the corporation but went to the trustees of the A estate and was distributed to the beneficiaries under the will. Hence, to include this 10x dollars in the assets of M Company, through a credit to the surplus account of the company, would be the recognition of appreciation based on going concern value.

The earnings of the business of the M Company undoubtedly justify establishing good will, but good will can only be set up on the books of a corporation and considered as invested capital for tax purposes when acquired by direct purchase. Article 57 of Regulations 41 reads:

If good will \* \* \* of a corporation or partnership \* \* \* has been purchased with stock or shares issued prior to March 3, 1917, the amount that may be included in invested capital must not exceed:

(a) 20% of the par value of the total stock or shares outstanding on that date, nor (b) the actual value of the asset at the date acquired, nor (c) the par value of the stock issued in payment for the asset.

Article 60 reads:

Good will and other similar intangible assets purchased with cash or tangible property must be taken at a value not in excess of the cash or actual cash value of the tangible property specifically paid therefor.

These articles do not contemplate a value measured by a collateral transaction, and while, as above stated, this corporation has undoubtedly

earned a good will value, there is no provision in the law for its inclusion in invested capital, except by purchase direct by the corporation or partnership. Appreciation arising from going concern value is not recognized in the Revenue Acts of 1917 and 1918 for invested capital purposes. The taxpayer has made reference in his contention to this Committee's Memorandum 21 wherein it is said:

If, upon the sale of the capital assets of a corporation to another corporation shares of stock are surrendered by the old stockholders to the vendee corporation, the nature of the transaction is not changed from one of the sale by the corporation to one of sale of stock by the stockholders.

In this transaction there was a sale of assets by several incorporated companies to another incorporated company, and as an incident of the transfer of the assets all of the stock of said companies was to be transferred and delivered at the time the sale and purchase was finally consummated. Accordingly, this was not a transaction between individuals.

The Committee finds no basis on which to establish a precedent by ignoring the corporate entity of the M Company and is accordingly of the opinion that the taxpayer's claim for good will of 10x dollars, measured by a transaction in the sale of stock of the corporation, by the stockholders to individuals, can not be sustained under the Revenue Acts of 1917 or 1918.

2

I('22)-14-204: A. R. R. 817

#### Section 207—Revenue Act of 1917.—Invested Capital.

Recommended in the appeal of the M Company, that the action of the Income Tax Unit, in its adjustment of invested capital, be sustained, and accordingly that the appeal be denied.

The Committee has carefully considered the appeal of the M Company from the action of the Income Tax Unit with respect to an increase of 50x dollars in invested capital as evidenced by an issue of capital stock having a par value of like amount.

The pertinent facts are related as follows: The appellant company was organized in 190— with a paid-in capital of 75x dollars and an authorized capital of 125x dollars. The company was organized for the purpose of purchasing the going business of the O Company, for which it paid 25x dollars cash and executed nine notes, eight for the sum of 10x dollars each and one in excess of 5x dollars (one note maturing June 1 of each year thereafter). These notes were all indorsed by the stockholders of the company. In 191— the company was embarrassed in the conduct of its business by reason of the heavy indebtedness which it carried and the consequent effect upon its credit. In order to relieve this situation, arrangements were made with A, the holder of the purchase money notes, to accept in lieu of five 10x dollar notes of the corporation, five personal notes of the stockholders of the company for similar amounts. The stockholders thereupon agreed to execute five 10x dollar notes in favor of the corporation in consideration of the balance of 50x dollars of the authorized and unissued capital stock of the company. Subscriptions for the unissued stock were duly taken in most cases and stock was receipted for, and all of it was left in the treasury of the company as collateral to the notes. These notes were immediately indorsed to A, and five of the corporation's notes of the same amount and of like dates, were taken up and canceled, thus reducing the indebtedness of the corporation by 50x dollars. Later, as these notes matured, they were taken up by the M Company in behalf of its individual stockholders, but the corporation still



held the notes and the capital stock. When the notes were paid by the corporation, the entry was posted from the cash book to a special dividend account.

The Unit in passing on the point involved stated:

The new corporation from time to time paid off these notes out of its earned surplus. None of the notes were paid by the stockholders who had signed them. The certificates of capital stock of the new corporation were attached to the notes as collateral security. The new corporation paid off the new notes on which it was the indorser at the rate of about 10x dollars per year, plus interest at 6 per cent, and retained the notes in its treasury for the alleged purpose of increasing its credit with out-of-town banks. This seems improbable in view of the fact that some of the stockholders' notes became as much as seven years overdue, and in view of the further fact that as soon as the notes were paid they were charged on the books to "Special dividend account." The new corporation claimed that these notes paid by the corporation are still assets of the corporation and should be included in its invested capital, in addition to the amounts paid in satisfaction of these notes, even though none of the interest and principal was ever paid by the stockholders who signed them, and they were when paid charged to "Special dividend account."

In the case here at issue the notes of the stockholders were paid for assets of the old corporation, the new corporation merely being the original payee and an indorser. The notes were satisfied out of the earnings of the new corporation and then allowed to become overdue without any attempt having been made to collect from the makers of such notes. Therefore, as fast as such notes are paid, they should be eliminated from invested capital, and the stockholders should report as dividends received the amounts so paid.

In connection with the position taken by the Unit, that the payments actually made were in fact dividend payments, the taxpayer states the following:

The declaration and payment of a dividend by a corporation may be legally accomplished only by certain formal action on the part of the board of directors of a corporation, and no such action was taken.

The question involved has been considered by the office of the Solicitor of Internal Revenue, which requested a brief from the taxpayer on the question as to whether the notes executed by the stockholders and indorsed over to A by the company, after having been redeemed by the company, constituted enforceable obligations against the stockholders under the statutes of the particular State, and further requested the corporation to submit for inspection its books containing the special dividend account, surplus account, regular dividend account, and its minute books of the directors' meetings. It developed that the capital stock books showed that the stock in question was in fact issued. Most of it had been receipted for, although certificates had never been removed from the stock book. The "special dividend account" and the "dividend account" shown on the ledger are identical with copies of book entries found in the file. The "Capital Stock account" on the ledger shows entries under date of June —, 190—, of 75x dollars, and February —, 191—, of 50x dollars, total capital stock issued 125x dollars. The "Surplus account" has been reduced by the amount of the regular annual dividend, but has not been reduced by the amount of the notes paid by the corporation. Copies of some of the notes were exhibited and the word "Canceled" appears in red ink across the face of the notes. Two notes were submitted in the sum of 10x dollars each, which were stated to be in renewal of notes which were barred by the statute of limitations. It developed, however, that these notes were renewed after the revenue agent made his investigation.

The taxpayer's brief on page 3, which was sworn to, states in part that:

Two of the notes as originally drawn were at the time of the revenue agent's investigation barred by the statute of limitations, their renewal having been overlooked. These two notes have been renewed in order that the obligation may be kept legally enforceable, and they will be exhibited at the hearing.

The minute books of the directors' meeting showed dividends regularly declared each year, a typical resolution being as follows:

On motion, a special dividend of 25 per cent on 75x dollars of capital stock be paid at once.

The minute books also show a resolution for each year from 1913 to 1917, inclusive, declaring a special dividend of 10x dollars to pay the stockholders' notes as they fell due. The typical record of such action is as follows:

A special dividend of 10x dollars to meet note for A, made by stockholders was ordered.

It is apparent, therefore, that the statements in the taxpayer's brief, that no dividend had been declared, is not in fact true.

The minute books also show that only z out of  $2\frac{1}{2}z$  shares of the stock were considered as voting stock, the z shares held as collateral for the notes evidently being treated as treasury stock.

The following is quoted from an informal memorandum written by the Solicitor under date of January 25, 1922, and the observations and opinion are subscribed to by the Committee:

It appears to this office in view of the additional facts gathered from the books that the capital stock of the corporation is 125x dollars and that the 50x dollars in notes issued for the 50x dollars stock in February, 1911, was an enforceable obligation against the stockholders of the corporation until the corporation paid each note by the declaration of a special dividend. It is not believed, however, that the notes can be treated as an asset of the company after they were paid out of the profits of the corporation in the form of a dividend to the stockholders. All of the stockholders signed the notes and were liable as between themselves in the same proportion as they held the stock of the corporation. A declaration of a dividend to pay the notes therefore was regular, and the earnings of the corporation were sufficient to pay the dividend regularly declared.

It is urged by the taxpayer that the action of the corporation and the stockholders is inconsistent with the theory that the declaration of a dividend was intended, but that the action taken should be construed to have been merely an authorization by the directors to the treasurer to take up these notes and hold them as an accommodation to the stockholders. The action of the directors and stockholders, however, does not seem to sustain this theory. The corporation's liability upon the notes was only secondary, and it was not obliged to take up the notes unless and until the stockholders had defaulted. It is affirmatively stated by the taxpayer and proven by other evidence that each of the stockholders is worth much more than his liability on these notes. The notes were interest bearing and in all the period since they were executed no stockholder has been called upon to pay any of the principal, nor has any stockholder paid any interest upon them. The notes were not due until June 1 each year, and without waiting for the due date or default of the stockholders the corporation declared dividends in February of each year to take up the notes when they became due June 1, and thus by its voluntary action legally obligated itself to the stockholders in advance to pay their obligation and charge it to their dividend accounts. Furthermore, when the notes were paid the cash entry was posted direct from the cash book to a special dividend account and the book-keeper who posted the entry is a stockholder, director, and secretary and treasurer of the corporation.

All further arguments of the taxpayer are based upon the fundamental error that the dividend was to be paid with the stockholders' notes, whereas at the time the dividends were declared and paid the corporation did not hold the notes of the stockholders which were being paid. Thus the taxpayer contends that if a dividend was in fact declared, it was never paid, whereas all the dividends in question were paid promptly, in cash, to A, the person to whom they were payable on behalf of the stockholders, according to the resolution declaring the dividend. It contends that the statute of limitations has now run against the stockholders and they can not enforce the collection of the dividends, whereas the dividends were paid on June 1 each year and the stockholders have no rights against which the statute may run. Again, it insists that the assets with which alone the dividends as declared might be paid were allowed to remain in the business and became paid-in surplus, when the dividends were payable, and were paid in cash from the earnings of the corporation; that the stockholders are estopped from claiming that dividends were declared, although they have received the payment of them in the payment of their notes.

No other conclusion can be reached than that the corporation did what its records indicate; that is, declared and paid a dividend out of its earnings each year in the sum



of 10x dollars for the payment of these notes, and it should have reduced its surplus accordingly.

It might be, as between the stockholders and creditors of the corporations, that the stockholders would be held estopped from denying that they still owe these notes to the corporation, but that is extremely doubtful, and could be determined only upon the happening of that contingency. However that may be, such an estoppel would not set up these notes as valid and legal obligations, but would only estop the stockholders from claiming that they had already been paid.

It is suggested, therefore, that the surplus account of the corporation be reduced each year by the amount which it paid as a dividend in satisfaction of these notes as they fell due. This conclusion necessarily reduced the corporation's invested capital by 40x dollars prior to the year 1917, and requires an adjustment on account of the 10x dollar note paid on June 1, 1917.

In view of the foregoing quoted opinion, with which the Committee is in accord, it is recommended that the surplus account of the corporation be reduced each year by the amount which was paid as a dividend in satisfaction of these notes as they fell due, and that the corporation's invested capital be reduced by 40x dollars prior to the year 1917 and a further adjustment of invested capital be made as of June 1, 1917, on account of the note paid through the medium of a special dividend on that date. Accordingly, it is recommended that the action of the Income Tax Unit be sustained and the taxpayer's appeal be denied.

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I ('22)-31-444: I. T. 1409.

#### Revenue Act of 1918.

Section 8632 of the Ohio General Code, which provides that at the time of making a subscription 10 per cent on each share subscribed for shall be paid, and which provides that the residue shall be paid in such installments at the times and places and to such persons as the directors require, has been construed by the Ohio courts as merely marking the time when the first installment shall be payable upon a stock subscription and as providing the mode for determining the time at which the residue shall become payable. (*Chamberlain v. Railroad*, 15 Ohio State, 249.) Stock issued without the payment of the first 10 per cent at the time of making the subscription is not invalid. (*Smith v. Railroad*, 15 Ohio State, 336, and *Henry v. Railroad*, 13 Ohio Reports, 187.) A note given for such 10 per cent is enforceable (*Latham v. Insurance Co.*, 1 Bull., 127.)

In view of the above interpretation, it is held that, under the provisions of section 8632 of the Ohio General Code, promissory notes of subscribers may legally be received in respect of the entire amount of stock subscribed. Consequently, it follows that all the notes received by the M Company upon stock subscriptions may be included in the company's invested capital to the extent of their fair market value at the time paid in under the provisions of article 833 of Regulations 45, provided they were received in absolute payment and not as conditional payment only.

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I ('22)-52-660: I. T. 1542.

### Revenue Act of 1918.

Inquiry is made whether under the laws of the State of New York notes may legally be received in payment for stock.

Section 326(a)1 of the Revenue Act of 1918 provides:

That as used in this title the term "invested capital" for any year means (except as provided in subdivisions (b) and (c) of this section):

Actual cash bona fide paid in for stock or shares; \* \* \*

Article 833 of Regulations 45 provides:

*Tangible property paid in: evidences of indebtedness.*—Enforcible notes or other evidences of indebtedness, either interest-bearing or noninterest bearing, of the subscriber received by a corporation upon a subscription for stock may be considered as tangible property in computing its invested capital to the extent of the actual cash value of such notes or other evidences of indebtedness at the time when paid in, but only (a) if such notes or evidences of indebtedness could under the laws of the jurisdiction in which the corporation was organized legally be received in payment for stock, and (b) if they were actually received by the corporation as absolute, and not as conditional, payment in whole or in part of the stock subscription.

With regard to incorporation under New York laws, section 55 of the stock corporation law provides that stock may be issued only for money, property, or services, and where a subscription is payable in money, section 53 requires 10 per cent of such subscription to be paid in cash. Section 29 provides that no corporation or officer thereof shall "discount any note or other evidences of indebtedness, or receive the same in payment of any installment \* \* \* due or to become due on any stock in such corporation." (Birdseys, Consolidated Laws of New York, p. 8205.)

Accordingly, under the laws of New York, any notes given for balances of stock subscriptions may not legally be discounted or received as payment for stock. Such notes, therefore, may not be included in invested capital under section 326 of the Revenue Act of 1918 and article 833 of Regulations 45.



II ('23)-38-1267: I. T. 1884.

**Revenue Acts of 1918 and 1921.**

A corporation which intended to extend its business increased its capital stock and issued the additional shares to its incorporators, who then executed their respective noninterest-bearing promissory notes for the amount of the stock received by each maker and placed the shares, with the notes attached in a bank, and entered into negotiations for a credit in case credit became necessary. Later the plan of extension was abandoned and this stock and the notes were recalled and destroyed, and the additional machinery and materials which had been purchased were paid for from the general funds of the corporation.

Promissory notes given under the conditions described are not bona fide paid into the corporation as is required by section 326(a)2 of the Revenue Acts of 1918 and 1921.

A corporation which contemplated building an additional plant obtained permission to increase its capital stock by  $x$  dollars for that purpose. Shares to that value were issued to the incorporators of the company in equal amounts. They then executed their respective noninterest-bearing promissory notes for the amount of the stock each maker received, and placed the shares of stock with the notes attached with a bank, and entered into negotiations for credit in case credit became necessary. Machinery and materials were ordered, but before their receipt the plan to establish a branch factory was abandoned and the stock and notes were recovered from the bank and destroyed. When the machinery and materials were received they were brought to the company's factory and paid for from the funds of the corporation, so that no money pledged to the new venture was used in any way, and the corporation, its assets and its capital stock, remained identically as they were prior to the proposed increase in the capital stock. Advice is requested whether the  $x$  dollars evidenced by the additional shares of stock and the promissory notes can be used as invested capital in computing the excess-profits tax for the year in which they were outstanding.

The item of  $x$  dollars increase in capital stock can not be included in computing the statutory invested capital of the corporation for any year or portion of a year. Section 325 (a) of the Revenue Acts of 1918 and 1921 defines tangible property as including notes and other evidences of indebtedness. Section 326(a)2 of these Acts states that invested capital means actual cash value of tangible property, other than cash, bona fide paid in for stock or shares. It is perfectly plain that promissory notes given under the conditions stated are not bona fide paid in to the corporation. The Bureau always considers the bona fides of any transaction through which the invested capital of a corporation is sought to be increased, and makes that feature one of the determining factors in deciding whether the invested capital may be increased, even though shares of stock were actually issued by the corporation to the extent of the increase claimed. While the citations given above are taken from the revenue Acts of 1918 and 1921, the same rule would apply should a case of this character arise under the Revenue Act of 1917.

In the instant case it was not necessary to consider whether the laws of the State in which the taxpayer corporation was organized permitted it to issue stock for notes. Ordinarily, however, this question is of primary importance when it arises in the determination of invested capital, and in such cases the rules announced in article 833 of Regulations 45 and 62 are controlling.





**Law Section 326.—Invested capital (1918 Act—¶555, ante): (1921 Act—¶1035, post).**

**Article 834.—Tangible Property Paid in: inadmissible Assets (Reg. 45—¶755, ante): (Reg. 62—¶1190, post).**

21-20-964: A. R. R. 111

#### REVENUE ACT OF 1917.

The Committee has had under consideration the appeal of the O Company. This appeal is based on two grounds: One, the action of the Unit in rejecting the claim for assessment under section 210, and the other, the disallowance, in the computation of invested capital under section 201, of an amount of  $x$  dollars representing capital stocks of other corporations owned.

At the time of organization, the business having been conducted originally by a partnership, no attention appears to have been given to the actual value of the assets assumed by the corporation, which started business with a capital stock of  $y$  dollars, and one of the grounds for the claim under section 210 is this defective accounting. It is understood, however, that in 1912, and again in 1913, the value of these permanent assets was appraised and written up and stock issued therefor, all of which has been allowed as invested capital. The other ground is that the corporation's income in 1917 was the fruits of previous activities. It is claimed that a large part of the income for 1917 was from a contract undertaken in 1916.

The matter of the company's claim for assessment under section 210 was under consideration by the Tax Reviewers and by them rejected, and the Committee sees no sufficient reason for a reversal of this action. Furthermore, it appears from a statement of the special assessment section that the company's excess profits tax was 41.49 per cent of the income and that statistics obtained from comparison of other corporations engaged in a like or similar business reflect an average tax of 40.14 per cent of the income.

The disallowance of the  $x$  dollars of inadmissible assets appears to grow out of the strict interpretation and application of article 44 of Regulations 41. This article, following the provisions of section 207 of the excess profits tax law, provides that "Stocks, bonds (other than obligations of the United States), or other assets, the income from which is not subject to the excess profits tax" may not be included in invested capital. This is merely a statement of the general principle adopted in the Act that borrowed money, interest on which is an allowable deduction, may not be included in invested capital, nor may assets the income from which is not included in the income account be included. The framers of the Act, however, did not foresee or make specific provision for a situation where inadmissible assets are purchased with borrowed money. It was clearly not the intention of Congress, where, for instance, a corporation has \$250,000 of admissible assets, \$250,000 of inadmissibles, \$250,000 of cash capital and \$250,000 of borrowed money, to hold that the corporation has no invested capital, nor does the law so provide *unless* the cash capital is invested in inadmissible assets.

When Regulations 41 were in course of preparation the method of meeting this situation was given very careful consideration and full discussion. It was recognized that in many, if not most instances, it would be impossible to earmark the dollar paid for inadmissible assets and to say whether it represented invested capital or borrowed money. It was therefore determined to give the taxpayer the benefit of the doubt, and this was done by paragraph 129 of article 53, which, after specifying certain adjustments necessary to be made, provides that the sum so found shall be the invested capital at the beginning of the taxable year, "except that in any case where

the admissible assets \* \* \* are less than the amount of such adjusted total, then the invested capital must be further reduced to an amount equal to the sum of the admissible assets." In drafting the form to put into effect this provision it was found to be an awkward thing to accomplish, and precisely the same result was accomplished in the method prescribed by Schedule C 8, Form 1103, and the instructions covering same; that is to say, if the admissible assets are in excess of the adjusted capital and surplus, no further deduction is required because of inadmissible assets; in other words, only the excess of inadmissible assets over total indebtedness is to be deducted from the capital and surplus so found.

Therefore, giving the intended effect to article 53 and to schedule 8 (c) of the form, the deduction of  $x$  dollars for inadmissible assets, which is much less than the outstanding indebtedness of the company, was not required, and the action of the Unit in further adjusting the capital and surplus by a reduction for inadmissible assets was erroneous, and the Committee therefore recommends that the corporation be advised to file claim for abatement of the amount of the assessment based on this error, or if claim has already been filed that it be allowed to such extent; and that the action of the Unit in rejecting the claim for assessment under section 210 be sustained.

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Law Section 326.—Invested Capital (1918 Act—¶555, ante): (1921 Act—¶1035, post).

Article 835.—Tangible Property Paid in; Mixture of Tangible and Intangible Property (Reg. 45—¶756, ante): (Reg. 62—¶1191, post).

16-19-120: T. B. M. 5.

Where since the organization of a corporation its capital stock has been increased or reduced and such change represents an actual acquisition of new property for stock or an actual impairment of original properties, the 20 per cent limitation imposed by section 207, Revenue Act of 1917, will be based upon the par value of the total stock outstanding on March 3, 1917.

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16-19-467: T. B. R. 49.

Article 59 of Regulations 41 is a reasonable interpretation of the Act of October 3, 1917, and where a corporation has acquired tangible and intangible property in exchange for its bonds and stocks it will be deemed, in the absence of clear evidence to the contrary, that the intangibles were acquired by the stock.

In computing consolidated invested capital, where one corporation has acquired the stock of one or more subsidiary companies, such transaction should be treated in effect as though the assets of the respective companies had been acquired. In the case under consideration, the decision of the income tax unit in allowing a 9 per cent deduction is approved.

(1) The W Company was formed through the merger of the Y Company and the Z Company with the W Company as it existed before the merger. The new company issued the following securities:

Bonds	67 x dollars
Capital stock	59 x dollars
Total bonds and stock	126 x dollars

The company also assumed liabilities amounting to 9x dollars. For the above securities and the assumption of the liabilities just mentioned the company acquired total tangible assets of 84x dollars and intangible assets of 51x dollars. In computing its invested capital for 1917 the company claims that these securities were issued ratably for both tangible and intangible assets, and that, therefore, 46 per cent of the bonds were issued for tangible and 54 per cent for intangible property. These ratios apply also to the common stock. Is this method of computation correct?

The act of October 3, 1917, provides that, where intangible assets, such as good will, trade-marks, trade brands, etc., have been acquired by capital stock, the maximum amount that may be included in invested capital in respect of such intangibles is limited to 20 per cent of the capital stock of the corporation outstanding on March 3, 1917. This is a purely arbitrary limitation designed to prevent the inclusion in invested capital of excessive amounts of capital stock issued for intangibles in excess of their reasonable value. Where capital stock is issued directly for intangible property, the application of this rule is simple, but where, as in the present case, a mixed aggregate of tangible and intangible property is acquired for the total amount of securities, part of which are in the form of bonds and part of which are in the form of stock, it becomes necessary to determine how much of the tangible property was acquired by bonds and how much, if any, by the issuance of capital stock. Regulations 41, article 59, lays down the rule that—

In the absence of satisfactory evidence to the contrary, it will be presumed in the case of a corporation that its stock was issued for the following purposes in the order named: (a)

Good will or other intangible property, (b) patents and copyrights, (c) tangible property.

Stating the rule conversely, bonds are to be applied first against tangible property, and any remainder only will be applicable to intangible property. There is no clearly stated rule in the statute; therefore the regulation is based upon inference, and to be sound must be a reasonable interpretation of what the statute requires. In any case in which a mixed aggregate of tangible and intangible property is acquired for a block of securities consisting in part of bonds of the corporation and in part of its capital stock, the allocation of the tangible and intangible property to the respective securities may be made upon one of three possible bases:

(a) That the stock was issued first against tangible property, and that the bonds were issued against intangible property;

(b) That the bonds and the stock apply ratably against the tangible and intangible assets; and

(c) That the bonds apply first against tangible assets, and that the stock was issued against any remaining tangible property and for the intangible property.

Considering briefly these possible bases, the first must be discarded as altogether unreasonable. Corporate securities are not and could not in any ordinary case be issued upon such a basis. The second basis is that claimed by the taxpayer, but it also must be discarded on the ground that it does not conform to the methods of corporate finance. Bonds are universally drawn in such a way as to rank senior to capital stock. A bond aims to give the maximum of security with a moderate rate of return, and this return, while limited in amount, is nevertheless a fixed obligation for the payment of which, together with the principal of the bond, tangible assets are specifically pledged. It is true that in some instances the mortgage or other instrument may cover not only tangible property but intangible property also, but even in such a case the satisfaction of the bond is first sought against the tangible property. The stock as the junior security is more speculative in character. It has no right of foreclosure and after satisfaction of the senior securities the stock must bear all losses. As against this, however, the stock is limited in its return only by the earning capacity of the corporation. Tangible property has an actual value resting upon its permanency and upon the variety of its possible uses. Intangible property is evanescent in its character, and its value rests upon its potential earning power and its use is limited usually to the trade or business in which it has its origin. It thus lacks the elements which make tangible property the accepted security for bonds, but because of its earning power it is a fitting basis for an issue of common stock. These distinctions are not merely theoretical but underlie the whole structure of corporate finance in this country, and are so interwoven with the practice and procedure in the issuance of securities that they have become, for all practical purposes, obligatory.

The rule laid down in article 59 of Regulations 41 is, in the opinion of the Advisory Tax Board, reasonable and fairly interprets the intent of the Statute. It is, therefore, recommended that the claim of the W Company to the right to compute invested capital upon the basis of prorating the bonds and stock issued by it over the tangible and intangible property be denied.

(2) In accordance with a court decree the W Company as it then existed was dissolved. Two new companies, the R Company and S Company, were organized and a certain portion of the tangible and intangible assets of the W Company was transferred to these new corporations. In this connection the W Company claims that the tangible and intangible property transferred at this time was acquired by it partly for bonds and partly for stock. This question is not material in view of the negative conclusion reached in (1)



above. This applied, however, only in so far as it relates to property acquired at the time of the merger and it may be that some part of the intangible property in the form of trade-marks or trade brands so transferred may have been acquired for cash or tangible property since that date. Proper recognition should, of course, be given to the facts in such an event.

(3) The W Company acquired through the merger already mentioned the stock of certain subsidiary companies. In the computation of the consolidated invested capital the Income Tax Unit has treated the acquisition of the stock of these subsidiary companies in the same manner as if the tangible and intangible assets of the respective companies had been acquired. In some cases these subsidiary companies have since been dissolved and upon dissolution the assets have been taken up by the parent company and the liabilities assumed by it. In the opinion of the Advisory Tax Board the method of computation used by the unit as above stated is correct.

(4) The W Company makes claim for prewar deduction of 9 per cent, although its actual earnings during the prewar period amount to less than this percentage of its invested capital. Representative corporations, however, show more than 9 per cent, and the W Company would have shown more than 9 per cent except for a charge that occurred during this period by way of premium paid upon certain bonds of the company which it had called in and canceled pursuant to the dissolution decree.

In view of all these circumstances, the Advisory Tax Board concurs in the decision of the Income Tax Unit that the taxpayer's claim should be allowed.

2

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44-20-1282: A. R. R. 307.

The Committee has had under consideration the appeal of the N Company against the ruling of the Income Tax Unit disallowing an item of 50x dollars claimed as good will in its invested capital for 1918.

The facts appear to be that the N Company, a corporation, succeeded N and Company, a partnership, in 1897. The partnership had been very profitable prior to incorporation, its average earnings for the five years just prior to 1897 being approximately 100x dollars. As its tangible assets presumably were substantially the same as when turned over to the corporation in 1897, 200x dollars, it is clear that its earnings indicated a good will worth at least as much as the tangible assets. The deed transferring assets to the corporation specifically recited that the 200x dollars in stock was paid for the trade name and good will of the business and the physical assets. The amount of the net tangible assets taken up on the books of the corporation was 200x dollars, the good will not being carried on the books as an asset at all.

The denial of the item of 50x dollars claimed as invested capital appears to be based upon the assumption that if allowed at all it must be allowed as paid-in surplus, and the Unit has consistently and correctly, in the opinion of the Committee, taken the attitude that no paid-in surplus is permissible directly or indirectly as to intangible assets conveyed. However, this amount may be allowed without its inclusion as paid-in surplus. The tangible assets taken over were raw materials and stock in trade which were sold long prior to any income tax law. To distribute the purchase price of the tangibles and intangibles purchased as being 150x dollars for tangibles and 50x dollars for intangibles will have the effect of reducing the cost price of assets from

200x dollars to 150x dollars and consequently increasing the earned surplus by 50x dollars.

It is clear that this is a case of acquisition for stock of a mixed aggregate of tangibles and intangibles such as would justify the application of section 327 if satisfactory allocation of values can not be arrived at. In view of the history of the concern and the profits earned in excess of a return upon tangible assets, the Committee is clearly of the opinion that the intangible assets were as readily worth 50x dollars as the tangibles were worth 150x dollars. However, as 50x dollars in 1918 is the maximum value which can be included in invested capital by reason of the purchase of intangible assets for stock, the Committee recommends that the corporation be allowed to allocate the values at the time of purchase and to attribute to the tangibles a cost of 150x dollars and to the intangibles a cost of 50x dollars, and to adjust its books so as to increase its earned surplus by the sum of 50x dollars.

3

II('23)-11-944: A. R. R. 2564.

### Revenue Act of 1918.

In 1909 the N partnership transferred all its assets to the M corporation for its entire authorized capital stock, par value 75x dollars. Their net worth, exclusive of good will, which was not set up on the books of the corporation, was more than 75x dollars. No portion of the good will can be included in the computation of invested capital. (A. R. R. 307 (C. B. 3, p. 344 [ruling No. 3, above] overruled.)

A corporation can not adjust the compensation paid to its officers during the prewar years 1911, 1912, and 1913 for the purpose of adjusting its war-profits credit for the year 1918.

The Committee has had under consideration the appeal of the M Company from the action of the Income Tax Unit in holding that it can not now adjust its net income for the prewar years 1911, 1912, and 1913, on account of certain amounts paid to its stockholders during those years and in holding that an item of 18.75x dollars can not be included in the computation of its invested capital for the year 1918.

Upon thorough consideration of the evidence the Committee finds: That appellant corporation was incorporated during the year 1909 with an authorized capital stock of 75x dollars, par value, for the purpose of taking over the business of the N Company, a partnership; that during the years 1911, 1912, and 1913 all of the authorized capital stock was outstanding and held by the former partners in the copartnership of the N Company; that its book net profits for the years 1911, 1912, and 1913 were:

	Dollars
1911.....	77.99x
1912.....	39.16x
1913.....	47.71x

(see revenue agent's report, dated July —, 1918); that during the years 1911, 1912, and 1913 it paid dividends on its outstanding capital stock as follows:

	Dollars
1911.....	30x
1912.....	56x
1913.....	37.5x

that during each of the prewar years its directors passed a resolution providing that the respective amounts set forth below be distributed among



its officers, who were also its sole stockholders, as salaries for that year:

	Dollars
1911.....	57.09x
1912.....	91.35x
1913.....	91.35x

that the amounts paid pursuant to the provisions of those resolutions were charged to expense; that the proportionate part of the total amount which was paid to each officer during the prewar years was based on stock ownership; that its officers did not receive during the prewar years any salary in addition to the amounts paid or accrued under the above-mentioned resolutions; that appellant corporation now desires to adjust the amounts paid to its officers as salaries during the prewar years "for the purpose of adjusting the war-profits credit on the return of net income for the year 1919 \* \* \*"; that the entire authorized capital stock of the M Company, a corporation, was issued during 1909 to the N Company, a copartnership, in payment of its assets; that the capital stock was issued for "all the personal property of every kind and nature belonging to said copartnership, consisting substantially of the property mentioned in inventory sheets accompanying this offer; also all choses in action of every kind and nature, including all accounts and bills receivable, patents and patent rights, copyrights and trade-marks, all contracts and agreements and the entire good will of said business, at a price of 75x dollars; the corporation to assume the payment of all bills and accounts payable and all claims and demands of every kind and nature against said firm, and the performance of all executory contracts and agreements"; that it was stated in a letter to the board of directors of the M Company, dated February —, 1909, that "Our last inventory, dated January —, 1909, shows that the net worth of said assets, without considering the value of patents, trade-marks, copyrights, and the valuable good will of the business, and placing a low valuation upon the stock and fixtures, to have been on said day more than 75x dollars, and that the net value of said business has increased since the day of said inventory and the day of the date hereof"; that the corporation did not set up good will on its books of account; and that appellant corporation contends that good will, in the amount of 18.75x dollars, be included in the computation of its invested capital for the year 1918.

The Committee further finds that, under the circumstances in this case, appellant corporation can not now adjust the compensation paid to its officers during the prewar years 1911, 1912, and 1913 for the purpose of adjusting its war-profits credit for the year 1918 (see O. D. 184 (C. B. 1, p. 273 [ruling No. 2 under Sec. 311, Art. 781, herein]); and that the amount of 18.75x dollars under the provisions of the Revenue Act of 1918 and the Regulations promulgated thereunder can not be included in the computation of its invested capital for that year.

Accordingly, the Committee recommends that the action of the Income Tax Unit be sustained.

\* \* \* \* \*

Appellant corporation has stated that the principle laid down in A. R. R. 307 (C. B. 3, p. 344 [ruling No. 3, above]) ) is applicable in this case in connection with its contention that the amount of 18.75x dollars, good will, should be included in its invested capital for the year 1918. In the opinion of the Committee the conclusion reached in A. R. R. 307 was erroneous and should not be followed in other cases.

**KINGMAN BREWSTER,**  
*Chairman Committee on Appeals and Review.*





**Law Section 326.—Invested Capital (1918 Act—¶555, ante): (1921 Act—¶1035, post).**

**Article 836.—Tangible Property Paid in; value in Excess of Par Value of Stock (Reg. 45—¶757, ante): (Reg. 62—¶1192, post).**

1-19-128: O. D. 89.

The value as at January 1, 1914, of tangible property paid in for stock or shares is no factor in computing invested capital under the Revenue Act of 1918.

1

1-19-129: O. D. 90.

Paid-in surplus representing tangible property need not be reduced by reason of depreciation of the property in question. All adjustments necessary on account of inadequate or excessive depreciation should be made in connection with earned surplus or undivided profits.

2

8-19-334: T. B. R. 32.

How invested capital shall be determined in the case of the X company where bondholders purchased at foreclosure sale the property covered by the mortgage securing the bonds, and then transferred said property to a new corporation in exchange for its total authorized stock issue.

The bondholders of the X Company obtained judgment against the debtor corporation in the amount of 4x dollars. The property of the corporation was sold and bid in by the bondholders for 3x dollars. The memorandum states that the cash value of the property was probably less than the judgment and probably more than the bid. After the property was bid in by the bondholders a new corporation with an authorized stock issue of 2x dollars was organized, and the property bid in at foreclosure sale by the bondholders was exchanged for the total issue of the stock of the new corporation. The inquiry is, What shall be the amount of the invested capital of the new corporation?

Article 153 of Regulations 45 provides that where under foreclosure a mortgagee buys in the mortgaged property and credits the indebtedness with the purchase price, the difference between the purchase price and the indebtedness will not be allowable as a deduction for a bad debt, for the property which was security for the debt stands in place of the debt. Article 1563, Regulations 45, also provides that there is no gain or loss arising from the acquisition and subsequent disposition of property when as a result of a transaction there is not a change in substance but merely in form of ownership. It is provided that there must be a change into the equivalent of cash to complete or close a transaction from which income may be realized. These regulations deny to the stockholders the right of taking loss upon the basis of any estimated difference in value between their investment in bonds and the property taken to secure such bonds.

Article 836 provides that evidence offered in support of a claim for a paid-in surplus may consist among other things of an appraisal of the property; certification of the assessed value in the case of real estate; and proof of a market price in excess of the par value of the stock or shares. It provides,

however, that "generally, allowable claims under this article will arise out of transactions in which there has been no substantial change of beneficial interest in the property paid in to the corporation, and in all cases the proof of value must be clear and explicit."

In the case of the X Company there has been no change of beneficial interest of the stockholders, and the Advisory Tax Board is of the opinion that the corporation should be allowed to set up an invested capital equal to the value of the property transferred to the corporation as of the date of transfer, such value to be established by evidence acceptable to the Commissioner. The question of gain or loss to the stockholders who were the former bondholders and the invested capital of the new corporation are not concurrent as to time of determination in the above case. The gain or loss of stockholders will be determined on the basis of the price paid for the bonds and the price received for stock of the new corporation when sold.

3

13-19-432: O. D. 249

Where a corporation exchanges its stock for the assets of a partnership, which are greatly in excess of the par value of the stock, and there is no written obligation to the partners as to the payment of the excess, the taxpayer is entitled to submit evidence in support of a claim for paid-in surplus; however, if the corporation is obligated to the partners for any portion of the excess, a claim can not be sustained.

4

14-19-440: T. B. M. 57.

The assets of a corporation can not be valued as of March 1, 1913, for the purpose of computing invested capital.

The X Company has appealed from a decision of the Income Tax Unit that it can not appraise its assets as of March 1, 1913, and use the values thus ascertained as a basis for determining invested capital. The company relies on *Lynch v. Turrish* (247 U. S., 221) and similar decisions, holding that appreciation prior to March 1, 1913, can not be considered net income for the purposes of the income tax.

An inspection of section 207 of the Revenue Act of 1918 with its reiteration of the phrase "value \* \* \* at the time of such payment" clearly shows that with minor exceptions the statutory invested capital is based upon the value of property at the time it is paid in for stock or shares and not upon a valuation at some subsequent date. The law has been consistently interpreted to mean that the basis or starting point in the computation of invested capital is found in the amount of cash or other property paid in, the original values of such other property being determined in accordance with the statute and the regulations. (Art. 42, Regulations 41.) In enacting the Revenue Act of 1918, Congress advisedly continued and confirmed this general principle. (Senate Rept. No. 617, p. 11; sec. 326, Revenue Act of 1918.) This well-established rule must be applied in the present case. The fact that this particular company has defective accounting records and can not accurately compute its invested capital in the ordinary manner may justify assessment under section 210 of the 1917 Revenue Act or section 328 of the 1918 Revenue



Act, but does not permit any appraisal of assets at a time subsequent to the date on which they were paid in for stock as a basis of a computation of invested capital.

5

21-20-965: S. 1387.

EXCESS PROFITS TAX, REVENUE ACT OF 1917, SECTION 207 (a), REGULATIONS 41, ARTICLE 63.

*Time of Valuation for the Purpose of Determining Invested Capital of Property Acquired by a Corporation by Gift.*

Where certain commercial leases to oil lands are informally transferred to a corporation formed by the lessees for the purpose of taking over such leases, no consideration being paid for such transfer, it will be deemed that the transfer was made at the time of taking possession, and the addition to invested capital of the corporation upon such transfer is the fair market price or value of the leases at the time possession is so taken by the corporation.

Opinion is requested as to the time when certain commercial leases should be valued for the purpose of determining the invested capital of the M Company which leases were informally transferred to the corporation without consideration by its stockholders.

The Revenue Act of 1917 provides, section 207.

That as used in this title, the term "invested capital" \* \* \* means \* \* \*

(a) In a case of a corporation or partnership \* \* \* (3) paid in or earned surplus and undivided profits used or employed in the business, exclusive of undivided profits earned during the taxable year; \* \* \*

Interpreting this section article 63 of Regulations 41 provides:

*When Tangible Property May Be Included in Surplus.*—Where it can be shown by evidence satisfactory to the Commissioner of Internal Revenue that tangible property has been conveyed to a corporation or partnership by gift or at a value, accurately ascertainable or definitely known as at the date of conveyance, clearly and substantially in excess of the cash or the par value of the stock or shares paid therefor, then the amount of the excess shall be deemed to be paid-in surplus. The adopted value shall not cover mineral deposits or other properties discovered or developed after the date of conveyance, but shall be confined to the value accurately ascertainable or definitely known at the time.

Evidence tending to support a claim for paid-in surplus under these circumstances must be as of the date of conveyance, and may consist, among other things, of (1) an appraisal of the property by disinterested authorities, (2) the assessed value in the case of real estate, and (3) the market price in excess of the par value of the stock or shares.

Prior to October, 1913, the M Company was a partnership. This partnership acquired leases to certain oil lands in consideration for its promise to begin drilling wells on the lands leased within a stated period of time, and to continue development. About October, 1913, the partnership instituted proceedings to incorporate. Immediately upon incorporation, and without formal record in any manner, the commercial leases held by the partnership were turned over to the corporation, which, thereupon, continued the work of drilling wells and developing properties. At the time of this formal transfer to the corporation the leases in question were of a value which can be determined with reasonable accuracy. A few months later, as a result of the development carried on by the corporation, the value of the leases became greatly enhanced.

It is the contention of the taxpayer that since the only way title to the leases could be acquired by the corporation was by fulfilling their individual requirements as to the developing of the properties, the leases were acquired on different dates, that is, the dates when permanent improvements were made by the corporation.

The excess profits tax law of October 3, 1917, authorizes a corporation to

include in "invested capital" as paid-in surplus the actual cash value of tangible property made the subject of a gift. Construing this provision, section 207 (a) 3, Regulations 41, article 63, provides that where tangible property has been conveyed to a corporation or partnership by gift or at a value accurately ascertainable or definitely known as at the date of conveyance, clearly and substantially in excess of the cash or the par value of the stock or shares paid therefor, then the amount of the excess shall be deemed to be paid-in surplus. That article goes on to state that the adopted value shall not cover mineral deposits or other properties discovered or developed after the date of conveyance, but shall be confined to the value accurately ascertainable or definitely known at that time. Although not definitely authorized by this article, the practice of the Bureau has been to regard as paid-in surplus the entire value of property made the subject of a gift at the date of its "conveyance."

The term "conveyance" is not used in this article in its strict technical sense, but means simply a transfer of the interest of the donor to the donee. This is shown by the fact that the article is concerned with tangible property in general, whereas, as is well known, the term "conveyance" is, strictly speaking, applied only to the formal transfer of real property by deed.

In the instant case it is undisputed that the entire interest of the partnership or the individual members thereof in the leases in question was transferred to the corporation at its date of incorporation.

While it is true that after such transfer of interest the corporation was required to continue the drilling of wells and the developing of the properties in order to carry out the terms of the original leases, still, so far as the partnership, the donor, and the corporation, the donee, are concerned, the entire interest of the former was transferred at the date of incorporation. The conditions which had to be fulfilled by the corporation did not affect the transfer of interest in the leases from the partnership, but simply the maintaining of the property in the leases as originally made.

As a general rule a sale of an interest in real property is held to occur at the time a deed passes or at the time possession and the burdens and benefits of ownership are, from a practical standpoint, transferred to the buyer, whichever occurs first. (See Law Opinion 988; Solicitor's Memorandum 1267, and cases therein cited.) The rule as to the effective date of a gift of an interest in real property for purposes of valuation should be the same as in the case of a sale. Since only the original parties are concerned, this conclusion is not affected by reason of the fact that the transfer was oral. In the instant case possession of the lands covered by the leases was taken immediately by the corporation; in fact such taking of possession is the only evidence of the transfer. Even if there had been a subsequent written assignment of the leases, such assignment would, for the purpose of fixing valuation, be retroactive to the time when the parties intended the property to pass, i. e., in this instance to the time when the corporation took possession and dealt with the leases as the owner thereof.

It is, therefore, held that where certain commercial leases to oil lands are informally transferred to a corporation formed by the lessees for the purpose of taking over such leases, no consideration being paid for such transfer, it will be deemed that the transfer was made at the time of taking possession, and the addition to invested capital of the corporation upon such transfer is the fair market price or value of the leases at the time possession is so taken by the corporation.



28-20-1064: A. R. R. 161.

## REVENUE ACT OF 1917.

Recommended that the claim of M. & Company for a paid-in surplus of 15x dollars on account of the excess value of properties in 1911 be allowed.

The Committee has had under consideration the appeal of M. & Company, a corporation, from the action of the Unit in disallowing a claim for 15x dollars as paid-in surplus in the determination of the corporation's invested capital for the purpose of adjusting excess profits tax.

M. & Company was organized in 1911 as a consolidation of two pre-existing corporations. Among other assets which were taken over by the present corporation and for which stock was issued were two pieces of real estate, the values of which are the basis of the present claim. One of these properties, the so-called warehouse property, was purchased by the original corporation at a cost of x dollars and on which a warehouse building was erected in the year 1902 at an actual cost of 2x dollars, this property having a book value of 3x dollars at the time of organization of the new company, at which value it was taken over, stock issued therefor, and the property set up on the books of the new corporation. The other, the main store building, was purchased by the original corporation at approximately 5x dollars, and there was erected thereon, in the years 1902 and 1903, a store building at an actual cost of 11x dollars, the property being carried on the books of the old corporation at 16x dollars, at which figure it was taken over and carried on the books of the new corporation. The claim for paid-in surplus arises on the alleged excess of value of the land on which these two buildings stand, in 1911. There was no substantial change of interest at the time of reorganization, the stockholders of the new corporation being practically the same as in the old.

Article 63 of Regulations 41 provides as follows.

Where it can be shown by evidence satisfactory to the Commissioner of Internal Revenue that tangible property has been conveyed to a corporation or partnership by gift or at a value, accurately ascertainable or definitely known as at the date of conveyance, clearly and substantially in excess of the cash or the par value of the stock or shares paid therefor, then the amount of the excess shall be deemed to be paid in surplus. The adopted value shall not cover mineral deposits or other properties discovered or developed after the date of conveyance, but shall be confined to the value accurately ascertainable or definitely known at that time.

Evidence tending to support a claim for a paid-in surplus under these circumstances must be as of the date of conveyance, and may consist, among other things, of (1) appraisal of the property by disinterested authorities, (2) the assessed value in the case of real estate, and (3) the market price in excess of the par value of the stock or shares.

It will be noted that the properties were taken over in January, 1911, and it appears that some time during the late summer of 1912 an appraisal was made of these two properties and the value of the main store lot, exclusive of the building, was appraised at 17x dollars, while the value of the warehouse lot, exclusive of the building, was appraised at 4x dollars.

The last paragraph of article 63 requires that "evidence tending to support a claim for paid-in surplus \* \* \* must be as of the date of conveyance," and the Unit has apparently rejected the claim on the theory that the appraisal, in order to be valid, must have been made on the exact date of conveyance. In the opinion of the Committee this is too narrow a construction. It is believed that the real meaning is that the appraisal must have been made as of that date; that is to say, in the light only of knowledge or facts ascertainable on that date and not in the light of subsequent happenings. Evidence was produced at the hearing to show that between January 1, 1911, the date of transfer, and the date of this appraisal there was no appreciable increase in the value of real estate in the locality. The appraisal then made has been substantiated by an appraisal subsequently made by two disinterested

appraisers as of January 1, 1911, who find the values only slightly different from those reached by the first appraisers, the recent appraisal being 4x dollars for the warehouse lot and 18x dollars for the store lot.

At the time of the appraisal in 1912, 5x dollars of the increase shown thereby was carried into the books of the company and a tax of 1 per cent paid thereon under the Act of 1909, under the mistaken view, subsequently reversed in the Baldwin Locomotive Co. case, that appreciation written on the books constitutes income. It is stated that the reasons for not then carrying the entire appreciation on to the books were that, first, they were under the impression that they would have to pay tax on all the amount written on the books; second, that an increase in book values might lead to an increase in their local taxation; and, third, and probably most cogent of all, was the fact that the stock was issued under a stockholders' agreement, under which no stock could be sold unless first offered to remaining stockholders, and that in the event of the death of any stockholder, the corporation had the right to purchase stock from his estate at approximately 10 per cent in excess of its then book value.

The store is advantageously located in the business center of the city, while the warehouse property is only a few blocks away. The properties clearly had a value in excess of that at which they were taken on to the books of the corporation in consolidation, and it has been abundantly established to the satisfaction of the Committee that the real estate had a value not less than 15x dollars in excess of the figure at which it was taken over.

It accordingly recommends that the claim of the corporation to an addition of 15x dollars to its invested capital as paid-in surplus be allowed.

7

2-21-1393: A. R. R. 358.

## REVENUE ACT OF 1917.

The Committee has had under consideration the appeal of the M Company from the action of the Income Tax Unit in denying to the taxpayer an invested capital as of January 1, 1913, based upon an appraisal of the taxpayer's property as of January 1, 1917.

It appears that the business which is now carried on by the M Company was organized by A in the year 1880. From that time until January 1, 1913, he carried on the business as an individual and was successful in building up a large business. During all this period, it is said that A kept practically no accounts beyond a few memoranda principally for the purpose of showing his current earnings from time to time. In the fall of 1912 he decided to incorporate the business, and as he was not dependent upon credit, he thought a corporation with a capital of 5x dollars would answer his purpose. Therefore on January 1, 1913, he turned over all the assets of the business to the new corporation, including cash and cash assets totaling 2x dollars, and machinery, fixtures, plant, and equipment valued, for the purpose of giving to the capital stock a book value equal to the par value thereof, at an arbitrary figure of 3x dollars. In return he received all the capital stock of the corporation.

After its incorporation few changes were made in the method of keeping the books of the company; and when early in 1917 it was discovered by the attorneys of the company that it was practically impossible to get from such books the necessary information for the proper preparation of income tax returns and also for the purpose of determining the amount of assets for



insurance purposes, a thorough and complete inventory and valuation were made and certified to by the N Appraisal Company, which showed the valuation of the plant as of the date of January 1, 1917, in the sum of 8x dollars.

Following this appraisal another firm of certified public accountants was engaged to make an examination of the books of the company from the time of its incorporation and to restate the company's accounts as of January 1, 1917, using for the valuation of the plant and equipment the figures as determined by the inventory and appraisal.

When it became necessary in the early part of 1918 to make up the excess profits tax return of the company for the year 1917, the N Appraisal Company was again engaged to value the plant, this time as of January 1, 1913, at which time the company took it over. This valuation was arrived at by deducting from the plant valuation as of January 1, 1917, the additions to equipment which had been acquired after January 1, 1913, allowing for depreciation and other adjustments to value. This computation showed a valuation of the plant as of January 1, 1913, in the sum of 7x dollars, which amount was 3x dollars more than the nominal sum at which the plant had been valued at the date of incorporation; and this is the value which the taxpayer desires to include in its excess profits tax return for the year 1917 for the purpose of determining its invested capital.

In their argument for the inclusion of this amount in the invested capital of the taxpayer, its attorneys rely upon article 63 of Regulations 41, and upon Recommendation 161 of this Committee [Sec. 326. Art. 836.—5, herein], which was based upon the regulations above referred to.

Article 63 of Regulations 41 is as follows:

Where it can be shown by evidence satisfactory to the Commissioner of Internal Revenue that tangible property has been conveyed to a corporation or partnership by gift or at a value accurately ascertainable or definitely known as at the date of conveyance, clearly and substantially in excess of the cash or the par value of the stock or shares paid therefor, then the amount of the excess shall be deemed to be paid-in surplus. The adopted value shall not cover mineral deposits or other properties discovered or developed after the date of conveyance, but shall be confined to the value accurately ascertainable or definitely known at that time.

Evidence tending to support a claim for a paid-in surplus under these circumstances must be as of the date of conveyance, and many consist, among other things, of (1) an appraisal of the property by disinterested authorities, (2) the assessed value in the case of real estate, and (3) the market price in excess of the par value of the stock or shares.

This Committee's Recommendation 161 (Bulletin 28-20-1064) was concerned with a claim for paid-in surplus on account of the excess value of properties in 1911, and in that case the Committee recommended the allowance of such excess valuation as invested capital; but the facts therein were quite different from those now under consideration.

In that recommendation the Committee held that in order to establish such excess valuation, it was not necessary that the appraisal should have been made upon the exact date on which the tangible property had been conveyed to the corporation; but only that the appraisal must have been made "*as of that date*; that is to say, in the light only of knowledge or facts ascertainable on that date and not in the light of subsequent happenings."

The tangible property, the value of which was then under consideration, was real estate and buildings, and the Committee held that inasmuch as the evidence was of such character that these values could be ascertained from all the surrounding facts *at that time* with an accuracy amounting almost to a certainty, therefore, the taxpayer was entitled to include that excess value in his invested capital, since the value, clearly and substantially in excess of the par value of the stock or shares paid therefor, was accurately ascertainable or definitely known as at the date of conveyance. It must be remem-

bered that the Bureau was here dealing with real estate and buildings and that the appraisal was made within two years of the date of valuation.

In the instant case the Bureau is asked to accept not an *appraisal* as of January 1, 1913, but an estimated figure resulting from a computation which was based upon an appraisal made as of January 1, 1917, or four years later; and this so-called appraisal is not merely a valuation of real estate and buildings, the value of which might be definitely ascertained even after so long a lapse of time, but of machinery and equipment, by an entirely empirical process of adjusting valuations obtained four years later; so that it can not be asserted or successfully maintained that the valuation as of January 1, 1913, was made "in the light only of knowledge or facts ascertainable on that date and not in the light of subsequent happenings."

The appraisers and the accountants were without doubt justified, for commercial purposes, in establishing the valuations and recasting the books as of January 1, 1913, by the best method at their disposal, which may have been the one employed; but the Committee does not believe that either the appraisers or the accountants would certify to the rigorous accuracy of such a valuation or of accounts established upon such a basis without qualifications which would render the valuation and accounts worthless for the purpose of computation of invested capital.

As a matter of fact, the taxpayer himself admits the unreliability of valuations so arrived at when he says in his brief that—

Using the valuation of the plant as of January 1, 1913, as shown by the appraisal, adding to that value the additions to the plant between January 1, 1913, and January 1, 1917, and deducting the depreciation charged off during the same period,

the plant had a valuation on January 1, 1917, as shown by the books of the corporation, in the sum of 7x dollars, as against the appraisal value at the same date of 8x dollars; and the taxpayer says, further, that—

Inasmuch as the books of the company had been restated by the accountants on the basis of the appraisement of January 1, 1917, it was evident that the item of plant had been entered on the books at x dollars in excess of the proper figures for invested capital, and accordingly in making up the company's return this excess amount was deducted from the invested capital appearing on the company's books; but while this tends to demonstrate the good faith of the taxpayer in making its claim, it shows conclusively the unreliability of the figures obtained by any such methods.

Therefore, the Committee recommends that the claim of the taxpayer for invested capital on January 1, 1913, based upon adjustments of an appraisal made as of January 1, 1917, be denied, and that the action of the Unit in disallowing such claim be sustained.

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7-21-1457; O. D. 813.

The M Company was organized subsequent to 1919. Soon thereafter it acquired all the capital stock of the N Company by issuing to the stockholders of the N Company its own stock in an amount equal to the par value of their shares of stock. The M Company thereupon by merger absorbed the N Company and became the owner of all the property of the N Company, which consisted of real estate, buildings, machinery and equipment, stock on hand, and work in process. This property had been purchased by the N Company in the same year at a bargain, as shown by an appraisal made of the property about the time it was taken over by the M Company.

Held, that the company could not include in its invested capital as paid-in



surplus the excess of the value of the property over the purchase price paid therefor. Any excess resulted from a successful bargain and is not paid-in surplus. Paid-in surplus as used in section 326 of the Revenue Act of 1918 does not mean the excess value of property purchased in a bona fide sale over the purchase price thereof. To constitute paid-in surplus of a corporation there must, in effect, be a gift to the corporation.

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I ('22)—5-60: A. R. R. 747.

### Revenue Acts of 1917 and 1918.

Recommended, upon the reconsideration of the appeal in the case of the M corporation from the action of the Income Tax Unit in holding that the invested capital can not be satisfactorily established and that assessment of excess profits taxes for the year 1917 should be made under the provisions of section 210 of the Revenue Act of 1917 and for subsequent years under the provisions of sections 327 and 328 of the Revenue Act of 1918, be reversed; that Committee on Appeals and Review Recommendation 490 sustaining the action of the Unit be revoked; that retrospective appraisals be accepted as evidence of paid-in surplus when made upon the basis herein outlined and the facts upon which the appraisals are based have been established by proof; that the retrospective appraisals and the facts upon which they are based in the instant case be verified to determine the method of their construction and the truth of the facts upon which they are based; and that in this and in all similar cases where the law directs that the value of property at a given basic date be ascertained, the Unit be instructed to receive such proof of the facts as is ordinarily accepted in important business transactions of like character and that the practice which has obtained in the Unit in refusing to receive such proof on the ground that it consisted of so-called retroactive appraisals be discontinued.

The Committee has reconsidered its Recommendation 490 (not published) in the matter of the appeal of the M corporation from the action of the Income Tax Unit in assessing excess profits taxes for the year 1917 under the provisions of section 210 of the Revenue Act of 1917 and for subsequent years under the provisions of sections 327 and 328 of the Revenue Act of 1918.

In a memorandum from the Unit transmitting this case to the Committee the following statement is made:

The corporation was organized in 1914 and took over the assets and assumed all the liabilities of two going concerns, the O corporation and the P partnership, the entire capital stock of the new corporation, 4x dollars, issued to the stockholders of the old corporation and the members of the partnership. The evidence submitted in the form of various appraisals shows that the assets acquired had a valuation far in excess of the capital stock. The corporation, however, could not submit any data showing the cost of the assets, as the records had been destroyed by water. In January, 1921, appraisals of the different classes of assets were made as of 1914 by different individuals assisted by others who were employed by the corporation in 1914. In the conference the manager of the corporation first stated the method used in determining whether the assets listed were acquired in the consolidation in 1914 was by taking an appraisal made in 1917 and eliminating therefrom all items shown by the books to have been purchased and charged to the asset accounts from 1914 to the date the appraisal was made. Later he stated that the appraisal was made by the former employees going through the department and listing the assets which from their own knowledge were acquired in the consolidation and afterwards comparing these items with the appraisal made in 1917.

In the consideration of this case it is necessary to refer to the provisions of the Revenue Act of 1917 which deals with tangible property paid in for stock. The pertinent part of section 207 (a) reads as follows:

\* \* \* (2) the actual cash value of tangible property paid in other than cash, for stock or shares in such corporation or partnership, at the time of such payment (but in case such tangible property was paid in prior to January 1st, 1914, the actual cash value of such property as of January 1st, 1914, but in no case to exceed the par value of the original stock or shares specifically issued therefor), and (3) paid in or earned surplus and

undivided profits used or employed in the business, exclusive of undivided profits earned during the taxable year.

Article 63, Regulations 41, interprets the foregoing provisions of the statute and reads as follows:

Where it can be shown by evidence satisfactory to the Commissioner of Internal Revenue that tangible property has been conveyed to a corporation or partnership by gift or at a value, accurately ascertainable or definitely known as at the date of conveyance, clearly and substantially in excess of the cash or the par value of the stock or shares paid therefor, then the amount of the excess shall be deemed to be paid-in surplus. The adopted value shall not cover mineral deposits or other properties discovered or developed after the date of conveyance, but shall be confined to the value accurately ascertainable or definitely known at that time.

Evidence tending to support a claim for paid-in surplus under these circumstances must be as of the date of conveyance, and may consist, among other things, of (1) an appraisal of the property by disinterested authorities, (2) the assessed value in the case of real estate, and (3) the market price in excess of the par value of the stock or shares.

The pertinent part of the Revenue Act of 1918 reads as follows:

\* \* \* (2) Actual cash value of tangible property, other than cash, bona fide paid in for stock or shares, at the time of such payment, but in no case to exceed the par value of the original stock or shares specifically issued therefor, unless the actual cash value of such tangible property at the time paid in is shown to the satisfaction of the Commissioner to have been clearly and substantially in excess of such par value, in which case such excess shall be treated as paid-in surplus.

Article 836, Regulations 45, interprets the foregoing quoted provision of the statute and reads in part as follows:

Evidence offered to support a claim for a paid-in surplus must be as of the date of the payment, and may consist among other things of (a) an appraisal of the property by disinterested authorities made on or about the date of the transaction; (b) certification of the assessed value in the case of real estate; and (c) proof of a market price in excess of the par value of the stock or shares. The additional value allowed in any case is confined to the value definitely known or accurately ascertainable at the time of the payment.

The records in the case show that for several years prior to 1914 the P partnership had conducted a repair business. In 190— a corporation known as the O corporation was incorporated, its entire capital stock being owned by the P partnership. In 1914 this corporation and the P partnership, consisting of A, B, and C, were consolidated and incorporated under the name of the M corporation, with a capital stock issue of 4x dollars. This capitalization was nominal and was not based on any valuation of either plant, as it was not deemed necessary to set an actual value on the asset because of the fact that all the corporate stock was held by the three members of the partnership. During the lifetime of A the partnership's accounting system was very lax and, as shown by a number of affidavits filed in behalf of the M corporation, all the books, balance sheets, and other accounting records of the P partnership and the O corporation were rendered useless during a storm in 1918, so that at the present time no records exist from which might be obtained a complete statement as to the cost of the assets taken over by the M corporation in the consolidation of 1914. Under these circumstances the Unit holds that the statutory invested capital of the corporation can not be satisfactorily determined, and proposes to make assessment of excess profits tax under the provisions of section 210 of the Revenue Act of 1917 and section 328 of the Revenue Act of 1918. The corporation has had various appraisals and estimates made in an effort to show the value of the assets in order to establish a claim for paid-in surplus, which appraisals may be classed as follows:

(1) Two appraisals were made by engineers versed in the particular line of business in 1917.



Each of the gentlemen who fixed upon the values shown above was undoubtedly well qualified to make appraisals covering the assets of the character owned by the M corporation, but it is to be noted that while there is a net difference of but 2x dollars between the totals of the two sets of figures no one unit was given the same value except in the case of automobiles, etc., the difference in the values given the other items ranging from  $\frac{1}{10}$ x dollars in the case of office furniture to  $2\frac{1}{2}$ x dollars in the case of other property, which in a measure indicates the difficulties experienced in fixing upon definite values.

(2) Three affidavits as to the value of the property taken over by the M corporation were submitted by persons familiar with values of such property.

Each of these gentlemen stated in his affidavit that of his own knowledge and belief the plant and equipment of the P partnership in 1914 was worth 60x dollars, while the fair value in 1914 of the plant and equipment of the O corporation as estimated by one of them was 241x dollars and by the other two about 240x dollars, although no value is placed upon any individual assets.

(3) Three affidavits similar to the next above made give a value of 291x dollars.

(4) A composite appraisal made in 1921—assets being divided into classes and itemized and each class appraised by men particularly qualified for the work, showing a total value as of 1914 of 304x dollars.

This last appraisal was taken subsequent to a conference held in 1920 between representatives of the taxpayer and members of the Income Tax Unit, during which the former were advised that in order to establish a claim for paid-in surplus evidence must be furnished showing the assets taken over upon consolidation, the cash value of the assets as of that date, the cost of subsequent additions by years, the proportion of such cost, if any, which had been included in the deductions claimed on taxpayer's returns, and the assessed value of the properties. To each individual appraisal which forms a part of this composite appraisal is attached an affidavit signed by the appraiser indicating the character of the work performed and the experience had by him in the past which would serve to qualify him to place fair and just values on the particular class of assets covered by his appraisal, but the appraisals contain little or no evidence of the facts upon which they are based and as to how they acquired their information or data to make up the appraisals, or as to how the appraisals were constructed. It was stated during a conference granted representatives of the taxpayer by this Committee that no assets were included in these appraisals except such as were positively known to have been in the possession of the P partnership and the O corporation and taken over by the M corporation at the time of consolidation except an item of "Hand tools," etc., valued at 4x dollars, with reference, to which the representatives of the taxpayer volunteered the information that such item was a mere estimate. No other proof is submitted to show how it was known that nothing was included except that which was in the possession of the company in 1914.

Accompanying this appraisal are statements taken from the books showing the amounts expended in the purchase of additional assets during the years 1914–1919, the amount of depreciation charged off during each of those years, and a summary showing the adjusted values of all lands, buildings, machinery, and equipment for the years 1914–1919 based on the appraisal made as of January 1, 1914.

As shown above, the appraisals forming the first set were taken in 1917 and show values as of that year. The affidavits forming the second and third sets contain nothing except general statements to the effect that in the opinion of the affiants the assets taken over upon consolidation were worth certain amounts in 1914. Neither of these appraisals or estimates, therefore, can be said to be of such a satisfactory and convincing character as to justify the acceptance of the values therein stated for invested capital purposes in the computation of excess profits tax liability without further investigation by the Unit to ascertain whether such values were computed upon the basis outlined herein.

The representatives of the taxpayer have stated to the Committee that their whole objection to assessment under the provisions of sections 210 and 328 of the Revenue Acts of 1917 and 1918, respectively, is on the ground that such a method of assessment affords no stable basis from year to year for a determination of the corporation's tax liability, for which reason they desire that the corporation be classed as one having a determinable statutory invested capital rather than as one entitled to relief under the provisions of the said sections even though its tax liability be greater under the first method than under the latter.

The values as stated in the four sets of appraisals mentioned above were apparently fixed by men who were well qualified for the work, but a different value is stated in each appraisal, which indicates the difficulties experienced in carrying out such a task and the practical difficulty in establishing cost. The first appraisal being taken at 1917 values, and the affidavits comprising the second and third appraisals, so called, being nothing more than general statements, can not be accepted.

The fourth appraisal, while stated in detail, shows in some cases approximations and not actual ascertainment of values. That part of this appraisal which covers fire protection system, plumbing and piping, indicates that the great majority of the items so covered was approximated, while that part which covers certain other property indicates that the quantity of material entering into the construction of such assets has been approximated. Errors in stated figures which affect the total value shown have also been made. While many of the assets covered by this appraisal are of such character and size, such as lands, large machines, etc., as to be easily identified as having been among the assets transferred, even after a lapse of years, by those who had worked with, around, and among them, and their value as of time of transfer more or less satisfactorily established, yet it is to be noted that this appraisal covers hundreds of very minor items which, because of their lack of size, importance, and cost, ranging in stated figures from a few cents to not more than \$50, lack distinctive character, and the Committee finds it hard to believe that such assets would so firmly fix themselves in the remembrance of any man or men as to permit such persons to positively identify them in 1921 as having been the identical articles which were in the hands of the P partnership and the O corporation and transferred to the M corporation in 1914, especially when it is known that many of such items were removed from a plant and reinstated and rearranged in new buildings in another community. It is also shown by an appraisal made in 1917, by competent men, and before the loss of the book records, that the value of the assets at that time was a little less than 240x dollars and there is nothing to show why the assets were worth approximately 60x dollars more in 1914 than in 1917.

It was stated in conference that since the consolidation in 1914 accurate book records have been kept from which it is possible to accurately deter-



mine just what additions to the plant had been made in order that the appraisals as of 1914 might contain nothing acquired since consolidation, and yet, in a statement filed with the Unit, the cost of such additions made during the year 1917 was stated as  $1\frac{1}{4}x$  dollars, while in a later statement such cost is stated as  $1\frac{1}{6}x$  dollars, which fact throws doubt upon the accuracy of such book records as have been kept. In the said appraisal the value of all flat lands, regardless of location or character, is stated at a certain amount per square foot, but no statements have been submitted showing the values placed thereon for local tax purposes.

In the consideration of the case the Committee has pointed out certain discrepancies in the appraisals which it is sought to have the Income Tax Unit accept as a basis for the allowance of a paid-in surplus. These discrepancies raise a doubt as to the accuracy of the figures submitted in such appraisals and of the facts upon which such appraisals are based. The appraisals in question are apparently based upon the opinions of persons qualified to testify in a matter of this kind, but it does not appear that the inventory of the assets of this corporation, as enumerated in the appraisals, has been valued upon a cost basis. It is thought possible to so value the assets in this case when the appraisals have been modified in accordance with the method hereinafter outlined and to this end the Unit should make or have made an independent appraisal for the purpose of verifying or checking the amounts and values stated in the appraisals submitted by this company before accepting same as representing sound values of the assets at the time they were paid in to the corporation in 1914.

In the past it has been the policy of the Bureau to construe strictly the requirements of article 63, Regulations 41, and article 836, Regulations 45 (1920 edition). As a result of such construction of these articles numerous retroactive or retrospective appraisals have been rejected as a basis for a claim for paid-in surplus. The Committee has made an exhaustive study of appraisals and their relation to invested capital of corporations. It has also considered appraisals in connection with establishing March 1 values for purposes of depreciation and depletion, and for purposes of establishing certain values in connection with amortization claims, and has reached the conclusion that the Unit has been too strict in interpreting the provisions of the statute and the articles of regulations interpreting same quoted above, and that retrospective appraisals, if made upon the basis hereinafter outlined and proof is furnished of the facts upon which they are based, may properly be accepted as a basis for the allowance of a paid-in surplus. The Unit, as well as the Committee, is continually fixing values for one purpose or another. This is particularly true in fixing the March 1 values for the purpose of computing gain or loss upon the sale of an asset which has been held for some time and which is of a class not regularly dealt in by the public.

In the instant case it is not only necessary to determine the actual cash value of the tangible assets at the time paid in in 1914 for the purpose of invested capital, but it is necessary to determine the fair market value of the depreciable property so paid in as at March 1, 1913, for depreciation purposes and also for the purpose of ascertaining whether or not the stockholders in the O corporation and the partners in the P partnership derived any profit from the sale of these assets to the M corporation. It is understood that the stockholders and copartners did not include any profit in the computation of their net income for the year 1914.

In making a retroactive or retrospective appraisal to show the actual cash value of tangible assets at the time paid in at some date in the past,

care should be exercised in order to eliminate any appreciation written upon the books of the corporation since the date of acquisition, and also to value the assets in question at cost. In the case of the *La Belle Iron Works v. United States* (C. B. 4, p. 373), decided by the Supreme Court on May 16, 1921, it was held that any appreciation in value of property over its cost is not to be included in invested capital as paid-in surplus. Treasury Decision 3220 (Bulletin 37-21-1822) was promulgated subsequent to this decision and requires the filing of amended returns in all cases where taxpayers have written appreciated or inflated values upon their books and have used same in determining the amount of their invested capital. It would, therefore, appear that no appreciation over cost can be recognized in the computation of invested capital and that appraisals made for the purpose of establishing invested capital and for the purpose of allowance of a paid-in surplus should be based upon the actual cost of the tangible properties as they existed at the time they were paid in, giving particular attention and consideration to the original cost and depreciated reproduction cost as at the basic date and the remaining expectancy of life. In order to accomplish this result it will be necessary to inventory at cost as of the basic date (the date of acquisition) the property then on hand and in many cases to establish by historical investigation the date of original acquisition, date of renewal, and the cost of additions made subsequent to the date the property was paid in. Adjustments should be made for property scrapped or discarded and for depreciation.

The books of account, if available, should be considered the best evidence as to dates of acquisition and actual cost. The asset account showing the tangible property may be incomplete for many reasons and may include property still on the books that has been discarded as well as property in existence that has never been capitalized or entered on the books and certain arbitrary amounts charged off as depreciation which have no relation to the expired and remaining life of the property.

The tangible property actually in existence and in use should be considered as the basic evidence of the invested capital in existence and should be used as a basis for the proper correction of the accounts to correctly reflect the actual investment in the depreciable properties in existence during the taxable years.

The burden of proof is upon the taxpayer when a claim for a paid-in surplus is made, and in so far as the records of the taxpayer may be incomplete or the regulations permit values of the property at the date paid in should be established by proof. The regulations quoted above do not prescribe any specific method for ascertaining the facts, but only indicate some of the means by which appropriate proof may be furnished which would be acceptable to the Bureau. A retrospective appraisal is in substance the opinion of experts based upon the facts presented to them and as such is admissible as evidence of a paid-in surplus, but its value as proof of a paid-in surplus must depend upon the truth of the facts upon which it is based. Necessarily, if any of the facts presented to the experts are not accurate, the experts' opinion is inaccurate to the extent that such facts are inaccurate. In order, therefore, for the Bureau to accept as conclusive a retrospective appraisal, it must be satisfied under the regulations that the facts upon which the appraisal is based are true. In determining whether or not the facts are true the Bureau should accept such proof of the facts as is ordinarily accepted in business transactions of like character. In all such inquiries the Bureau is dealing with facts which themselves come within the control



of human will or human caprice, and the evidence for which depends on the trustworthiness of human informants. Such evidence may range through every degree, from the barest likelihood to that undoubted moral certainty on which every man acts without hesitation in practical affairs. The Bureau must receive and consider such appraisals, therefore, with a sound and intelligent discretion as it considers much other evidence, and be content to accept them, without being able to prove their accuracy as mathematicians judge accuracy, if they convince the mind of their correctness to that moral certainty upon which practical men of affairs act.

In view of the foregoing, it is recommended that the action of the Income Tax Unit in holding that the invested capital can not be satisfactorily established and that assessment of excess profits taxes for the year 1917 should be made under the provisions of section 210 of the Revenue Act of 1917 and for subsequent years under the provisions of sections 327 and 328 of the Revenue Act of 1918 be reversed; that Committee on Appeals and Review Recommendation 490 sustaining the action of the Unit be revoked; that retrospective appraisals be accepted as evidence of paid-in surplus when made upon the basis herein outlined and the facts upon which the appraisals are based have been established by proof; that the retrospective appraisals and the facts upon which they are based in the instant case be verified to determine the method of their construction and the truth of the facts upon which they are based; and that in this and in all similar cases where the law directs that the value of property at a given basic date be ascertained, the Unit be instructed to receive such proof of the facts as is ordinarily accepted in important business transactions of like character and that the practice which has obtained in the Unit in refusing to receive such proof on the ground that it consisted of so-called retroactive appraisals be discontinued.

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I('22)-6-83: Sol. Op. 129.

### Excess Profits Tax—Revenue Acts of 1917 and 1918.

Where water power is developed and applied on the same parcel of land by virtue of riparian rights of the owner of the land, its value is an element of the value of the land and should be treated as tangible property for the purpose of determining invested capital.

Where a number of small dams at a given point are acquired by a corporation and consolidated as one dam, the proper measure of value of the property thus acquired, for the purpose of determining invested capital, is the total value of all the powers thus acquired, valued separately.

Where water power is valued at a certain amount per horsepower, the valuation in such cases should relate to horsepower actually developed at the date of valuation and not to the estimated potential power.

The question has arisen as to whether water power should be treated as tangible or intangible property for the purpose of determining invested capital under the Revenue Acts of 1917 and 1918.

A claim was filed by the M Company for the abatement of  $8x$  dollars corporation income and excess profits taxes for the calendar year 1917, and  $8\frac{1}{2}x$  dollars corporation income and excess profits taxes for the calendar year 1918. A claim was also filed by the Q Company for the abatement of  $2\frac{1}{2}x$  dollars corporation income and excess profits taxes for the calendar year 1917. The last-named company is a subsidiary of the former, and consolidated returns for the income of both corporations were made and the tax assessed upon the two corporations on that basis. Owing to the consolidation, this case will be treated as one involving a single claimant.

It is stated in a memorandum submitted to this office that the claims are based on additional information furnished in conference and with amended returns relative to an increase in depreciation deduction, and an increase in paid-in surplus for excess value of water power rights over the par value of capital stock issued therefor. It does not appear from the memorandum submitted with respect to what property deductions for depreciation are claimed, nor the amount of these items nor the basis upon which such items were adjusted. No opinion, therefore, is given relative to the adjustment of depreciation allowance.

In connection with the water power values, it appears that in 190- claimant acquired the property of several companies and individuals, which properties were used in the operation of wing dams on the Y River, issuing in payment therefor  $18\frac{1}{3}x$  dollars par value of its stock. In 190- claimant removed all the wing dams and constructed a dam across the entire river, hereinafter referred to as the O Powers. In 191-, claimant acquired the assets and assumed the liabilities of the P Company operating the R dam and issued its stock in payment therefor. In both cases claimant owns the land adjacent to the dam where the power is developed.

Claimant submitted evidence in support of the contention that the water powers in question were of an actual value of  $105x$  dollars at the time the purchase thereof was made with the capital stock of the corporation, and in computing its invested capital, included  $85x$  dollars as paid-in surplus. In the memorandum submitted to this office it is recommended that  $44\frac{2}{3}x$  dollars be allowed as paid-in surplus, for the reason that such amount represents the excess in the actual value (as accepted in conference) of the water power rights acquired over the par value of the capital stock issued therefor.

Under section 207(a) 2, 3, of the Revenue Act of 1917, and article 63 of Regulations 41, and also under section 326(a)2, of the Revenue Act of 1918, and articles 836 and 837 of Regulations 45, the value of tangible property clearly and substantially in excess of the par value of stock issued in exchange therefor by a corporation may be treated as paid-in surplus. Article 63 Regulations 41, provides:

ART. 63. *When tangible property may be included in surplus.*—Where it can be shown by evidence satisfactory to the Commissioner of Internal Revenue that tangible property has been conveyed to a corporation or partnership by gift or at a value, accurately ascertainable or definitely known as at the date of conveyance, clearly and substantially in excess of the cash or the par value of the stock or shares paid therefor, then the amount of the excess shall be deemed to be paid-in surplus. The adopted value shall not cover mineral deposits or other properties discovered or developed after the date of conveyance, but shall be confined to the value accurately ascertainable or definitely known at that time.

Evidence tending to support a claim for a paid-in surplus under these circumstances must be as of the date of conveyance, and may consist, among other things, of (1) an appraisal of the property by disinterested authorities, (2) the assessed value in the case of real estate, and (3) the market price in excess of the par value of the stock or shares.

Article 836 of Regulations 45 provides:

ART. 836. *Tangible property paid in: value in excess of par value of stock.*—Evidence offered to support a claim for a paid-in surplus must be as of the date of the payments, and may consist among other things of (a) an appraisal of the property by disinterested authorities made on or about the date of the transaction; (b) certification of the assessed value in the case of real estate; and (c) proof of a market price in excess of the par value of the stock or shares. The additional value allowed in any case is confined to the value definitely known or accurately ascertainable at the time of the payment. No claim will be allowed for a paid-in surplus in a case in which the additional value has been developed or ascertained subsequently to the date on which the property was paid in to the corporation, or in respect of property which the stockholders or their agents on or shortly before the date of such payment acquired at a bargain price, as for instance, at a receiver's sale. Generally, allowable claims under this article will arise out of transactions in which there has been no substantial change of beneficial interest in the property paid in to the corporation, and in all cases the proof of value must be clear and explicit.



The questions arise in this case as to whether the items of water power involved are to be treated as tangible property, and if held to be tangible property, whether it has been established that they had a value at the time they were acquired clearly and substantially in excess of the par value of the stock issued in exchange therefor.

Section 325 of the Revenue Act of 1918 defines intangible property as "patents, copyrights, secret processes and formulae, good will, trade-marks, trade brands, franchises, and other like property" and tangible property as "stocks, bonds, notes, and other evidence of indebtedness, bills and accounts receivable, leaseholds and other property other than intangible property."

There are two distinct and entirely different things which may be referred to as a water power. First, there is the natural condition consisting of a fall or rapid in a stream and which may be regarded as latent until some means are created to utilize it; second, when water has been accumulated in a dam so that the potential power has become a reality and is in condition so that it can be parceled out for use, this is also referred to as water power, and is the kind of a water power involved in the instant case. In either case, however, the power belongs to the riparian owner by virtue of his ownership of the riparian land.

Under the common law, every riparian proprietor is entitled to the natural flow of any stream through or along his land in the accustomed channels, undiminished in quantity and unimpaired in quality, except as may be occasioned by the reasonable use of the stream by other like proprietors. (Farnham on Waters, Vol. I, p. 63; 27 E. C. F. Waters, p. 11; *Crawford Co. v. Nathaway*, 67 Nebr., 325; 93 N. W., 781; *Sanborn v. Peoples Ice Co.*, 82 Minn., 43; 84 N. W., 641.) In some States this rule is not followed, and there is what is called the doctrine of prior application, and then again in other States there is a mixed application of the two doctrines. The doctrine of prior application prevails generally in the Pacific States. According to this doctrine, the person who first appropriates the waters of a stream for a beneficial use has the first right thereto, whether he be a riparian owner or not.

In the State of Wisconsin the common-law rule is in force. (*Lawson v. Mowry*, 52 Wis., 219; 9 N. W., 230; *A. C. Cann Co. v. Lumber Co.*, 74 Wis., 652; 43 N. W., 660; *Kaukeums Power Co. v. Green Bay Co.*, 75 Wis., 385; 44 N. W., 638; *Fox River Co. v. Kelly*, 70 Wis., 387; 35 N. W., 744.) In the case of *State v. Bancroft* (148 Wis., 124), the court in speaking of the right of a riparian proprietor referred to it as "unquestionably a private right appurtenant to the land." Riparian rights are generally referred to as incorporeal hereditaments, appurtenant to the land through which the water flows, which will pass with a conveyance of the land without any designation. (27 R. C. L., 1340.) Farnham on Waters (vol. 2, p. 1567) states:

While the water right is incorporeal, it is not personal property, but is a parcel of the estate and therefore partakes of the nature of real estate and in so far a part of the estate to which it is attached that it is an incident of, and will pass with it.

Riparian rights are reflected in the value of the land to which they attach and often give the land its chief value. These rights are property rights and can not be taken from the owners without just compensation. *State v. Bancroft*, supra. The property of the owner consists not in the water itself but in the added value which the stream gives to the land through which it flows. While water power itself is simply energy generated by flowing water, we are here dealing with the ownership of that energy, which involves the ownership of tangible property inseparably connected therewith.

In valuing the land and physical property thereon necessary for power generation, no line can be drawn between the value of the land and physical property on the one hand and the water power on the other. It can be not said in placing a value upon an entire dam that the water rights are reflected in the value of the land only to a certain point and that any value of the dam in excess thereof must be valued separately as power. The combination of the water rights, the land, machinery, and equipment combined together make up the power which may be valued at so much per horsepower and the water power can only be valued as a separate item to the extent that it enhances the value of the land and the other physical property necessary for power generation.

Where, as in this case, a person owns the land upon which a dam is built and owns the water power developed by virtue of his riparian rights in the land, it is the opinion of this office that such power is so connected with the land to which it is appurtenant that it should be treated as tangible property to determine invested capital.

Having determined that water power should be treated as tangible property, we come to the question of whether or not it has been established in this case that the water powers in question had a value at the time of their acquisition in excess of the par value of the capital stock issued therefor,

This value in the case of the O Power must be as of 190-, and the P Power as of 191-, as those are the dates the respective properties were acquired. (Art. 63, Regulations 41, and art. 836, Regulations 45.) The computation in the memorandum is based on an estimated power at the O dam of  $3\frac{3}{4}x$  horsepower and at the R dam of  $2x$  horsepower, and while there is evidence upon which to base the findings of value as agreed upon in conference of  $r$  dollars per horsepower, the record does not disclose that this amount of power was ever developed at either of these dams at the date of their acquisition. The O Power was created through the consolidation of several small companies, each developing power by means of wing dams. The record does not disclose how much power each of these companies was developing or could develop. Claimant, after acquiring the properties of the companies operating the small wing dams, in 190- constructed a dam across the river and the estimates of power developed seem to relate to the power capable of being developed after the construction of such dam, as none of the companies could develop more than an  $s$ -foot head, while if combined, a head of  $4s$  feet could be developed.

The increase in power which could be developed by a consolidation of all the powers at this point was not a reality until after the acquisition of the property necessary to construct the entire dam. There was no doubt an appreciation in the value of the property purchased by claimant which could be measured by the increased power capable of development, but the appreciation arose by reason of the combination of several powers which necessarily could not take place until after their acquisition. The proper valuation, therefore, to be given to the O Power for the purpose of determining the invested capital is the total value of all of the powers acquired valued separately.

In the case of the R Power acquired in 191- it appears that it was necessary to expend the sum of  $11\frac{1}{2}x$  dollars additional after the purchase for the purpose of acquiring riparian rights, and since the acquisition of the property the claimant has obtained the permission of the water power commission to hold the water at  $3s$  feet, instead of  $2s$  feet, the limit of the franchise which had heretofore existed at the place. The allowance of invested capital in this case was based on  $2z$  horsepower, but it does not appear in



the record that the 2x horsepower was developed at the R dam at the date of its acquisition and prior to the time the above changes were made. If a water power is to be valued by the number of horsepower developed, it must relate to the horsepower developed at the date of the valuation and not to the estimated potential power which may be developed at some future time under changed conditions. Article 836, Regulations 45, above quoted, provides that no claim will be allowed for a paid-in surplus in a case in which the additional value has been developed or ascertained subsequently to the date on which the property was paid in to the corporation. It is the opinion of this office that this provision has application to valuation of a water power, and that in valuing a power at a certain sum per horsepower, it should relate only to the actual power developed at the time of the acquisition of the property. Any other method would be too speculative and uncertain to meet the requirements of the law that the value must be established "clearly and substantially" in excess of the capital stock issued in exchange therefor. The record does not show that the amount of horsepower claimed by taxpayer, or as allowed in conference, was developed at the dams on the dates of their acquisition, and it is the opinion of this office that it has not been established by claimant that the power in question had any value in excess of the value of the capital stock issued in exchange therefor.

Carl A. Mapes, *Solicitor of Internal Revenue*.

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(See A. R. R. 844; sec. 331, art. 941. Ruling No. 16.) Value in excess of par value of stock upon reincorporation which effected merely a change of domicile.

12

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I ('22)-16-231: I. T. 1285

### Revenue Act of 1918.

The M corporation acquired from a partnership a lease to certain property at a cost of 100x dollars, which amount represented the cost of the lease to the partnership, and paid for the lease in stock, so that the members of the partnership thereby became minority stockholders of the corporation. An appraisal was made, immediately after incorporation, of the value of the lease, which showed it to be worth in excess of 300x dollars, and thereupon the corporation made a book entry increasing its paid-in surplus by 200x dollars, representing the excess value of the lease over its cost price.

It is held, that the amount of 200x dollars added to the book value of the lease does not constitute paid-in surplus, and that the transaction should be considered as a purchase and sale between a vendee corporation and a vendor partnership which resulted in a substantial change of beneficial interest. The fact that the corporation may have acquired a bargain by the purchase of the lease does not authorize it to increase its surplus by reason of the alleged excess value of the lease over the amount which was paid for it.

13

I ('22)—18-258: A. R. R. 761

**Revenue Act of 1918.**

Recommended, in the appeal of the M Company, that the action of the Income Tax unit in disallowing the claim for additional invested capital in the amount of 1,291 $\times$  dollars for the year 1919 be sustained and the appeal denied.

The Committee has carefully considered the appeal of the M Company, of L, from the action of the Income Tax Unit in disallowing a claim for additional invested capital for the year 1919 in the amount of 1,291 $\times$  dollars.

In 190— there was organized under the laws of the State of Z, the O Company for the purpose of manufacturing machines. In 190— the O Company reorganized under the laws of the same State as the R Company, with an authorized capital stock of 8,000 $\times$  dollars. The following year the N Company was organized under the laws of the State of L, with an authorized capitalization of 6,000 $\times$  dollars, and with practically the same stockholders, for the purpose of manufacturing and selling, within the United States and dependencies and Canada, machines under the patents held by the R Company. Working capital for the N Company was secured by the sale of preferred stock to the stockholders of the R Company. These two affiliated corporations continued business until October, 1913, when the N Company, being in financial difficulties, its affairs were turned over to a bondholders' committee. At the same time the R Company was dissolved and its properties were taken over by its directors as trustees (in dissolution).

In October, 1913, the aggregate outstanding capital stock of the two corporations was 9,449 $\times$  dollars and their net assets were 980 $\times$  dollars, divided as follows: Tangibles, 542 $\times$  dollars; intangibles, 438 $\times$  dollars. In June, 1914, a new corporation, known as the M Company, was incorporated under the laws of the State of L with an authorized capital stock of 1,500 $\times$  dollars, divided as follows: 2y shares of common stock of the par value of \$100 each and y shares of deferred stock of a like par value. The assets of the R Company were sold by the trustees (in dissolution) on March —, 1914, through A, as agent, to B at public sale. On October —, 1913, D, upon application of the bondholders' committee, was appointed receiver for the N Company of L, by the District Court, and in accordance with an order of that court he, as receiver, sold on April —, 1914, all the assets of the N Company to E and on the — day of April did assign, transfer, and set over to the said E all right, title, and interest in and to the assets and property of the said N Company. B and E, upon the organization of the M Company, assigned all the assets of the R Company and the N Company, purchased by them as above stated, to the new company for capital stock of the new company in the amount of 980 $\times$  dollars.

It is alleged by the M Company that the actual cash investments in the R Company and the N Company aggregated 2,271 $\times$  dollars, and it is contended that the excess of this amount over the amount of stock issued for the assets of the two companies, to wit, 1,291 $\times$  dollars, should be included in invested capital as paid-in surplus for the year 1919.

Section 326(a) of the Revenue Act of 1918, approved February 24, 1919, provides:

That as used in this title the term "invested capital" for any year means (except as provided in subdivisions (b) and (c) of this section):

- (1) Actual cash bona fide paid in for stock or shares;
- (2) Actual cash value of tangible property, other than cash bona fide paid in for stock or shares, at the time of such payment, but in no case to exceed the par value of the original stock or shares specifically issued therefor, unless the actual cash value of such tangible property at the time paid in is shown to the satisfaction of the Commissioner to have been



clearly and substantially in excess of such par value, in which case such excess shall be treated as paid-in surplus; \* \* \*

(4) Intangible property bona fide paid in for stock or shares prior to March 3, 1917, in an amount not exceeding (a) the actual cash value of such property at the time paid in, (b) the par value of the stock or shares issued therefor, or (c) in the aggregate 25 per centum of the par value of the total stock or shares of the corporation outstanding on March 3, 1917, whichever is lowest. \* \* \*

From the above statement of facts, it appears that the intangible assets of the R Company and the N Company were paid in for stock prior to March 3, 1917. The invested capital of the M Company, therefore, for the year 1919 must consist of the actual cash value of the tangible property paid in for stock or shares at the time of such payment (sec. 326(a)2) plus an amount of intangibles fixed by the limitations prescribed by section 326(a)4. The statute provides for a paid-in surplus only in connection with tangible property paid in (sec. 326(a)2) and by its terms (sec. 326(a)4) expressly excludes from invested capital any amount in excess of the par value of the stock or shares issued for intangibles. This has been the uniform holding of the Bureau. As the total value of the tangible assets paid in for stock or shares was less than the par value of the stock or shares issued, it is clear that a claim for paid-in surplus based upon the original cost of the assets to the original companies can not be allowed.

The taxpayer contends that the beneficial ownership in the new company and the former companies is substantially the same, and that, therefore, the new company is but a continuation of the former companies and entitled to the same invested capital. The soundness of this contention can not be conceded. The present company was organized as a new company under its own charter and is not a continuation of the N Company, which remained in existence. Neither did it acquire the assets of the N Company through succession to that company but by purchase at a receiver's sale authorized by the United States District Court. There is still less ground for contending that the present company is in any way a continuation of the R Company. The present company is organized under the laws of a different State and acquired the assets of the first-named company through purchase at a sale by the trustees (in dissolution) and its title is in no sense a continuation of the title of the former company. The identity of the stockholders does not destroy the separate entity of the corporations nor constitute one a successor of the others. As stated in the case of *Pittsburgh and Buffalo Company v. Duncan* (232 Fed., 584, 587):

The mere fact that the stockholders in two corporations are the same, \* \* \* does not make either the agent of the other, nor does it merge them into one, \* \* \* where each corporation is separately organized under a distinct charter.

This is but a statement of the principle which has been consistently recognized by the Federal courts. See *Peterson v. Chicago, Rock Island & Pacific Railroad* (205 U. S., 364); *Conley v. Mathieson Alkali Works* (190 U. S., 406, 409); *Pullman Car Company v. Missouri Pacific Co.* (115 U. S., 587, 597). And it is the position taken by the Bureau. Law Opinion 1062 (C. B. 4, p. 168).

The cases of *Southern Pacific Company v. Lowe* (247 U. S., 330) and *Gulf Oil Corporation v. Lewellyn* (248 U. S., 71), referred to by counsel for the taxpayer as involving a departure from this principle are, as pointed out by the Supreme Court, based upon their peculiar facts and are believed to be readily distinguishable from the instant case. As stated in *Eisner v. Macomber* (252 U. S., 189, 213, 214):

\* \* \* looking through the form, we can not disregard the essential truth disclosed;

ignore the substantial difference between corporation and stockholder; treat the entire organization as unreal; look upon stockholders as partners, when they are not such; treat them as having in equity a right to a partition of the corporate assets, when they have none. \* \* \* We must treat the corporation as a substantial entity separate from the stockholder, \* \* \*

Upon full consideration the Committee accordingly recommends, in the appeal of the M Company, that the action of the Income Tax Unit in disallowing the claim for additional invested capital in the amount of 1,291x dollars for the year 1919 be sustained and the appeal denied.

14

I ('22)—27-386: A. R. R. 944

**Section 207, Revenue Act of 1917, Section 326, Revenue Act of 1918.  
Section 203, Revenue Act of 1918.**

Recommended, in the appeal of the M Company, that the action of the Income Tax Unit in excluding from invested capital for 1917 and subsequent years approximately 300x dollars as paid-in surplus and in increasing income for 1918 by 2x dollars representing an adjustment of inventory at December 31, 1918, be sustained and the appeal be denied.

The Committee has had under consideration the appeal of the M Company from the action of the Income Tax Unit in excluding from invested capital for 1917 and subsequent years approximately 300x dollars claimed as paid-in surplus and in increasing income for 1918 by 2x dollars representing an adjustment of inventory as at December 31, 1918.

The M Company was organized in 190— and acquired the assets and business of the N Company under the circumstances briefly stated as follows:

The business conducted by the N Company had been in existence for a great many years and the stock of the company was widely scattered, being held mostly by small stockholders and trustees. Of the stockholders at date of organization, 76 per cent owned less than five shares each or were fiduciaries. The management of the affairs of the corporation seems to have been centered in the A and B interests, which actually owned a small minority of the stock.

Prior to 190— it appears that the business of the N Company had been steadily unprofitable. Accordingly, the stockholders at an adjourned special meeting held in 190—:

Voted, that the directors shall have authority to liquidate the company and to sell any or all of its plant and property, except its corporate franchise, at public or private sale from time to time in such manner, upon such terms, and for such considerations as shall seem to them to be for the best interests of the stockholders.

The A interest through C, an attorney and also son-in-law of A, in whose hands, as stated above, the management of the company seems to have been centered, immediately instituted a scheme of reorganization. Under date of January, 190—, the directors, under authority of the action of the stockholders above quoted, gave to C an option to purchase for 60x dollars cash, within 30 days, all of the assets of the company excepting the merchandise inventory on hand or in process. In order to raise the money necessary to exercise this option, C set about securing subscriptions to stock in a new company which he proposed to organize for the purpose of acquiring the assets and operating the business of the old company. Under date of February —, 190—, these subscribers entered into a so-called "underwriting agreement," wherein they pledged to pay into the new company, or to C for the company, the sum set opposite their respective names. The total amount pledged was 100x dollars, of which only 31x dollars represented subscriptions



by stockholders in the old company. Several pertinent clauses of this agreement are here quoted:

Said C shall endeavor to acquire the plant and assets of said N Company at a price not exceeding 60x dollars for everything except the franchise of the company and except stock, raw, wrought, and in process, and articles of supply and repairs on hand; and he shall use subscriptions received hereunder for the purposes of such acquisition.

Should he so acquire the property, he is to cause a new corporation to be organized under the laws of Y, with a capital stock not to exceed 120x dollars (one class), and transfer all the said property and the cash capital herein provided for to such new company, taking such capital stock in payment.

The subscribers hereto shall be entitled to shares of the new company of a par value equal to the amounts of their respective subscriptions, or the proceeds thereof at par as herein provided.

All the stock so received by said C shall, however, be first offered by him, in such reasonable manner as he may determine (and with or without assignable rights), to the existing shareholders of said N Company for subscription at par within such time as he may limit.

At a meeting of the board of directors of the N Company held in February, 190-, the treasurer was authorized and empowered "to seal with the corporate seal, acknowledge and deliver at the present time or any future time in the name and on behalf of the corporation a deed or deeds and an assignment or assignments of" all of the assets of the company except those specifically named "to the M Company, a corporation duly organized under the laws of Y." Pursuant to the stipulation in the "underwriting agreement," a part of which is quoted above, C, under date of February, 190-, sent a circular letter to each stockholder in the N Company, notifying him or her that he (C) had purchased all of the assets of the corporation and had caused the same to be conveyed to a new corporation known as the M Company; that the capital stock of the new company was 120x dollars (par value of each share \$100); that each stockholder in the N Company was offered the unassignable right to purchase for cash at par stock in the new company in the proportion of five shares in the new company for each share in the old company, and that such offer must be accepted and the cash remitted before March, 190-, failing in which it would be conclusively presumed that the offer was declined. A few of the stockholders in the old company availed themselves of the opportunity thus afforded and purchased stock in the new company. After subscriptions were all in it is shown that the stock was taken as follows:

	Per cent.
By stockholders in the N Company.....	42½
By outsiders.....	57½

The new company thus had paid-in capital stock of 120x dollars represented by:

	Dollars.
Plant.....	60x
Cash working capital.....	58x
Organization expenses.....	2x

(C was paid 2x dollars for his services.)

The old company was then liquidated, the stockholders receiving in liquidation about 5 cents on the dollar invested.

A few months after the acquisition of the assets here in question the appellant (the new company) had an appraisal made for insurance purposes. This appraisal, a copy of which is in the file, shows a total asset value of approximately 440x dollars, and the company claims that after providing for proper depreciation, these assets had an actual cash value at date of acquisition of 365x dollars, and that inasmuch as only 60x dollars in stock was issued therefor, it is entitled to include in invested capital the excess value, or 305x dollars, as paid-in surplus.

The Committee has given very careful consideration to the elaborate arguments, oral and written, advanced by the appellant's representatives in connection with the provisions of the Revenue Acts of 1917 and 1918, and finds itself utterly unable to agree with their claim that a substantial compliance with the necessary conditions for allowing paid-in surplus has been effected. Both section 207 of the Revenue Act of 1917 and section 326 of the Revenue Act of 1918 provide that invested capital means the actual cash paid in for stock or shares and (or) the actual cash value of tangible property paid in for stock or shares. In the opinion of the Committee, the facts in this case show conclusively that the M Company was organized with 120x dollars cash paid in, 57½ per cent of which was supplied by outside interests, and that 60x dollars of this cash was paid to the N Company for the assets of the latter. It is further shown that only approximately 20 per cent of the stockholders in the N Company became stockholders in the M Company. It seems fallacious, therefore, to argue that the assets of the N Company were paid in to the M Company for stock of the latter when 80 per cent of the stockholders of the former received none of this stock. For the same reason the argument that the N Company or the stockholders thereof contributed to the M Company value which was not paid for appears to be equally untenable. All of this only emphasizes the soundness of the provisions of article 836, Regulations 45, which lays down the rule that:

Generally, allowable claims under this article will arise out of transactions in which there has been no substantial change of beneficial interest in the property paid in to the corporation and in all cases the proof of value must be clear and explicit.

The Committee is therefore forced to the conclusion that the action of the Unit in rejecting this claim for paid-in surplus was correct and should be sustained.

The facts relative to the second point before the Committee on appeal are briefly as follows:

During 1918, due to war conditions, the company was obliged to take deliveries as they could be obtained. Storage facilities near the plant being inadequate, it was necessary to store some material outside the premises and about a quarter of a mile from the plant. In taking the inventory at December 31, 1918, the company deducted therefrom the amount of 2x dollars as the estimated expense of hauling this material from the place where it was stored to the regular storage space within the premises. The corporation states that it uses the cost or market, whichever is lower, basis for its inventories and contends that upon this basis it was correct to inventory the material stored outside the mill premises at cost, less the estimated expense of hauling it from the ground where it was stored to the regular storage space at the plant.

The Committee feels that this contention is entirely without merit and fails to meet the two essential tests to which inventories must conform as laid down in article 1582, Regulations 45, as amended by Treasury Decision 3296.

It is therefore recommended, in the appeal of the M Company, that the action of the Income Tax Unit in excluding from invested capital for 1917 and subsequent years approximately 300x dollars as paid-in surplus and in increasing income for 1918 by 2x dollars, representing an adjustment of inventory at December 31, 1918, be sustained and the appeal be denied.



I ('22)-51-650: A R. R. 1276.

Act October 3, 1917, Section 207. Act February 24, 1919, Section 326.

Recommended, in the appeal of the M Company, that the action of the Income Tax Unit in reducing the appellant's invested capital as of July —, 1914, to 63.29x dollars be reversed and that the appraisal as of that date, now filed, subject to check as to individual items, be made the basis of the computation of invested capital.

The Committee has carefully considered the appeal of the M Company from the action of the Income Tax Unit in reducing its invested capital as of July —, 1914, from 158.35x dollars to 63.29x dollars.

The N Company, which had operated as a domestic corporation for a number of years, was declared bankrupt in 1913 and was in the hands of receivers in bankruptcy until July —, 1914. A creditors' committee was appointed and a proposed plan of organization adopted under date of September —, 1913. The plan of reorganization provided:

The new corporation shall issue such amount of first preferred stock as shall be necessary for the distribution to creditors as hereinafter provided.

The new corporation shall also issue approximately 20x dollars par value of common stock or such other amount as the committee may deem proper.

In order to raise additional working capital the committee may offer to preferred stockholders of the N Company a right to acquire, for each two shares of the preferred stock of the N Company now held by them, one share of first preferred stock and one share of 6 per cent second preferred stock (of the par value of \$—) of the new corporation upon payment of an amount equal to the par value of the new first preferred stock so acquired. In such case the new corporation shall issue such additional amount of first preferred stock and such amount of second preferred stock as may be required for the above purposes. Such second preferred stock, if issued, shall not entitle the holders to voting rights in any event for five years, and thereafter only if dividends then accruing remain unpaid.

The reorganization plan further provided that each creditor who entered into it should receive an amount of first preferred stock equal in par value to the amount of his claim at the date of bankruptcy with interest at the rate of 6 per cent from said date to the date when dividends began to accrue on such preferred stock.

As to the common stock, the reorganization plan provided:

The committee shall itself hold the common stock of the new corporation, or cause the same to be held by such persons as it may deem proper under a voting-trust agreement, such voting-trust agreement to be continued for a period of not more than 10 years, or for such shorter period as they may deem proper. Such voting trust agreement may provide that the committee holding such stock may agree with A (subject to such other conditions and limitations as the committee may deem proper for the protection or benefit of first preferred stockholders or as such agreement may provide) that if the new corporation shall redeem all of said first preferred stock at par with all accumulated dividends within five years of the date as of which the same is issued, said common stock shall be delivered to him as his own property. If no such agreement is made, or if the common stock is not so disposed of, the committee holding the same shall within 10 years dispose of or use the same for the benefit of the first preferred stockholders, or for the protection or benefit of the new corporation in such manner as in the committee's sole discretion it may deem proper or as said voting-trust agreement shall otherwise provide.

Pursuant to the last quoted provision, voting trustees were appointed by the creditors' committee and an agreement was entered into between the voting trustees and the M Company, in which it was recited:

Whereas in pursuance of said plan, a new corporation has been formed called the M Company, which, in accordance with the direction of the committee, has issued all its capital stock (except w shares of common stock subscribed for in cash) for the purpose of acquiring substantially all the property (except \$—) of said N Company, bankrupt, or of the trustees in bankruptcy thereof; and

Whereas nearly all the preferred stock of said M Company, has been or is to be transferred to the parties to said agreement of reorganization in proportion to their claims against said bankrupt, as provided in said agreement, any balance of the total authorized preferred stock of the company not so transferred to be held as treasury stock or otherwise for the benefit of the corporation; and

Whereas all of the common stock of said M Company, namely 50w shares of the par value of \$—— each, is now held by B for the benefit of said committee and the persons whom they represent;

And in which it was agreed among other things that:

At any time before July —, 1919, the trustees may, in their absolute discretion, by an affirmative vote of or writing signed by four of their number, make an agreement with A (former proprietor of the N Company) that if the M Company, a State of U corporation, shall, before July —, 1919, redeem all of its outstanding preferred stock at par with all accumulated and unpaid dividends thereon, and if such other conditions and limitations as the trustees may insert in said agreement for the protection or benefit of said preferred stockholders shall be fulfilled, then, upon the fulfillment of all the conditions and limitations above referred to, the trustees will convey all the shares held in trust hereunder to said A upon his written request. Said agreement shall not extend in any manner beyond July —, 1919, and if not then performed shall immediately expire.

The agreement with A thus authorized appears to have been made.

Pursuant to the plan of reorganization, the assets of the N Company were on July —, 1914, taken over by the M Company, which assumed all the former corporation's liabilities and issued preferred stock for the amount of their claims proven in bankruptcy, aggregating in all 146.84x dollars par value of preferred stock and 1.51x dollars of preferred scrip, in all 148.35x dollars, and 10x dollars of common stock was issued to the voting trustees in pursuance to the agreement above stated.

From the statement of facts filed in support of the appeal it appears that:

Just prior to the reorganization, the books of the N Company showed total assets of 263.3x dollars and total liabilities, excluding capital stock, of 218.7x dollars. When the new corporation's books were set up, the plant was taken at a nominal valuation. Real estate carried on the former books at 79.58x dollars was set up on the new books at 35.6x dollars; machinery and equipment carried on the old books at 94x dollars was set up on the new books at 14x dollars; an inventory of finished goods carried on the old books at 11.1x dollars was set up on the new books at 5.55x dollars, one-half the former book value. The plant account was thus marked down 123.99x dollars and the inventory 5.55x dollars, making a total reduction of assets of 129.55x dollars. The preferred stock took the place of nearly all of the accounts and notes payable of the old corporation and the new corporation began business with a book deficit of 95x dollars, created by the process of writing down assets as before mentioned.

In its returns for 1917, the appellant increased the items of machinery and real estate taken over from 14x dollars to 60x dollars and from 35.6x dollars to 40x dollars, respectively. The increased values thus claimed were disallowed by the Income Tax Unit, only the amount of 49.6x dollars set up on the opening account of the new corporation being allowed on account of these items.

There has now been filed a complete appraisal of the assets of the appellant company made on January —, 1920, as of July —, 1914. This appraisal shows the cost as of July —, 1914, and accrued depreciation as of the same date as follows:

Assets.	Cost July —, 1914.	Accrued depreciation July —, 1914.
	Dollars.	Dollars.
Land.....	10. 24x	.....
Buildings.....	63. 26x	10. 5x
Machinery and equipment.....	88. 01x	15. 38x
Total.....	161. 51x	25. 88x

Sound value July —, 1914, 135.63x dollars.

The affidavit on behalf of the appraisal company states as to the method of making the appraisal:



The object of making this inventory was to determine the actual cash value of the physical property as of July —, 1914. A complete inventory of all items of plant and equipment on hand and in active use at January —, 1920, was taken. The date of installation of all items added since July —, 1914, has been determined from the records of the company, careful analysis of plant and expense accounts having been made by accountants. These items were further checked by information obtained from employees in the plant and the remaining items are, therefore, considered to be the items which must necessarily have been in place on July —, 1914. The prices applied to the items acquired from July —, 1914, to January —, 1920, have been actual cost prices taken from the records of the company by the accountants who worked in conjunction with the engineers.

It was then necessary to determine the value of the remaining items of equipment in the inventory as of July —, 1914.

The first step was to determine the reproduction cost of these items as of July —, 1914. This was done by using the records of the previous corporation and the records of the O Company. Preference was given to records of the previous corporation when these were available, with the exception of the buildings of the plant which were acquired at a bankrupt sale. Records of the O Company are made up almost wholly of actual sales to numerous corporations and are not based on quotations or prices given "for appraisal purposes" and are, therefore, we believe, the best evidence of the market price. Every effort has been made to have the prices applied conservative.

The reproduction cost having been determined, the next step was to determine the depreciated value and this was arrived at as follows: Competent engineers made careful examinations of each item of equipment to determine its actual condition and the accrued depreciation as of January —, 1920, was thus determined. Yearly depreciation rates were then determined and the entire plant worked back to January —, 1914, all as shown by accompanying schedules.

In explanation of the method adopted, the appraiser has sworn:

I have investigated the accounts of the predecessor corporation of the M Company and in my opinion it is impossible to correctly determine the plant value as of July —, 1914, from their books of account.

The method of accounting then in use does not show, and it is impossible to determine from the books, the expenditures made for rebuilding, renewals, replacements, and extraordinary repairs. Plant items also were charged to expense in some cases, and no consistent method of depreciating the property was ever used.

It is now contended by the appellant that the value of the buildings and machinery and equipment as of July —, 1914, as shown by the appraisal, should be employed in computing the invested capital and that in addition there should be included the par value of the 10x dollars common stock, for the reason that it represented the value to the company of the five-year agreement with A which was reasonably worth the par value of the stock.

Transmitting the appeal the Unit states:

The Unit has taken the stand that the values established by the corporation and set up on its book should be used in the absence of more definite proof of the value of the property involved. The values shown on the books can not be analyzed and it is a well recognized fact that the assets of bankrupt concerns are very often inflated.

With this in mind, we find that the officers of the new corporation revalued the assets and wrote them down to such an extent that a capital impairment of over 60 per cent resulted. The Unit contends that the officers of the corporation would not reduce the book values of its assets to a figure below the actual worth of the assets, if by so doing a substantial capital impairment was shown, unless the original values of the assets were inflated.

The Committee has carefully examined the appraisal submitted in this case and finds that it has been prepared in the manner stated by the appraisers, that the rates of depreciation used were liberal, and that it complies with the requirements of T. D. 3367 (Internal Revenue Bulletin I-30, p. 17) [¶1288 herein].

It is, therefore, believed that the appraisal constitutes sufficiently definite proof of the value of the property involved as of the date paid in for the purpose of computing invested capital, subject, of course, to check by the Unit as to the particular items and rates of depreciation.

The contention of the appellant, however, that the par value of the 10x

dollars of common stock should be added in computing invested capital does not appear to be well taken. As shown by the above recitation of facts, all the capital stock, including the common stock with the exception of *w* shares which were issued for cash, was issued for the assets of the N Company and not in consideration of services rendered or to be rendered by A. It is expressly provided in the contract entered into between the creditors' committee and A that the common stock was to be turned over to him only upon the redemption of the preferred stock within a period of five years and not otherwise. In other words, it was to be used to pay him a bonus for retiring the preferred stock within the period stated. Until the stock was actually retired, no title whatever vested in A, and the only thing back of it was the assets of the N Company, the value of which as of July —, 1914, for the purpose of invested capital has already been allowed in full in this recommendation.

It is, therefore, recommended, in the appeal of the M Company, that the action of the Income Tax Unit in reducing the appellant's invested capital as of July —, 1914, to 63.29 $\times$  dollars be reversed and that the appraisal as of that date, now filed, subject to check as to individual items, be made the basis of the computation of invested capital.

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II('23)-2-724: A. R. M. 192.

### Act February 24, 1919, Section 326(a) (2) and (3).

In the matter of the allowance of a paid-in surplus under the provisions of section 326(a) (2) and (3).

The Committee has carefully considered the request of the Income Tax Unit for an opinion whether the "bargain price" clause of article 836 of Regulations 45 (1920 edition) applies with equal force in each of the four following cases where the property is acquired at a receiver's sale:

(a) When the purchasers are creditors who are in no wise connected with either the old or new corporation except as creditors of the old as in T. B. M. 49 (C. B. 1, p. 282 [Sec. 326. Art. 831.—3, herein.]).

(b) When the purchasers are creditors who are also stockholders in both corporations.

(c) When the purchasers are the stockholders (not creditors) of both the old and new corporations.

(d) When the purchasers are composed of both creditors and stockholders of the old and new corporation.

It is stated that the request is made for the reason that differences of opinion have arisen as to the proper interpretation of T. B. R. 32 (C. B. 1, p. 286 [Sec. 326, Art. 831.—1, herein]) and T. B. M. 49, particularly as to the inferences to be drawn from the language of paragraphs 4 and 5 of T. B. M. 49.

The paragraphs of T. B. M. 49 referred to read:

There is a difference of opinion as to whether the  $\times$  dollars actually paid in to the Z Company in return for their stock should be considered the total invested capital of the new corporation or whether the view should be taken that the new business is substantially a reorganization of the old, and, therefore, the invested capital be fixed upon that basis.

It would appear that the first of these views is correct. The Y Company went into the hands of a receiver and its property was sold to its creditors who were not the stockholders of the corporation. The title to this property passed absolutely to the purchasers who were in no wise connected with the old corporation except as creditors. The transaction was closed and completed so far as the old corporation and its stockholders were concerned.



The difficulties of the Unit appear to have arisen from the statement of the Advisory Tax Board that—

The Y Company went into the hands of a receiver and its property was sold to its creditors *who were not the stockholders of the corporation*. The title to this property passed absolutely to the purchasers who were in *no wise connected with the old corporation except as creditors*.

It is to be noted that two questions were presented to the Advisory Tax Board in the case there considered. First, whether what was done constituted a reorganization; second, whether the new corporation was entitled to a paid-in surplus on account of the assets taken over from the old corporation. The expressions in *italic* appear to the Committee to have been used as bearing directly only upon the first question, to wit, whether the transaction constituted a reorganization of the old corporation or the creation of a new corporation, a question which only becomes material where the transaction occurred subsequent to March 3, 1917.

Section 326 of the Act of February 24, 1919, provides:

(a) That as used in this title the term "invested capital" for any year means

(2) Actual cash value of tangible property, other than cash, bona fide paid in for stock or shares, at the time of such payment, but in no case to exceed the par value of the original stock or shares specifically issued therefor, unless the actual cash value of such tangible property at the time paid in is shown to the satisfaction of the Commissioner to have been clearly and substantially in excess of such par value, in which case such excess shall be treated as paid-in surplus:

(3) Paid-in surplus

Construing the above provisions of the Act, article 836 of Regulations 45 (1920 edition), as amended by T. D. 3367 (Internal Revenue Bulletin I-30, p. 17), after prescribing the evidence acceptable to establish a paid-in surplus, provides:

No claim will be allowed for paid-in surplus in respect of property which the stockholders or their agents on or shortly before the date of such payment acquired at a bargain price, as for instance, at a receiver's sale. Generally, allowable claims under this article will arise out of transactions in which there has been no substantial change of beneficial interest in the property paid in to the corporation, and in all cases the proof of value must be clear and explicit.

Article 837 of Regulations 45 (1920 edition) provides that—

Where it is shown by evidence satisfactory to the Commissioner that tangible property has been paid in by a stockholder to a corporation as a gift or at a value definitely known or accurately ascertainable as of the date of such payment clearly and substantially in excess of the cash or other consideration paid by the corporation therefor, then the amount of the excess shall be deemed to be paid-in surplus.

The question of paid-in surplus arises in connection with (1) tangible property paid in for stock and (2) tangible property paid in by a stockholder or stockholders by way of gift or for a consideration substantially less than its value. The considerations governing the determination of the question of paid-in surplus in the two cases are not substantially different.

In the case considered in T. B. R. 32 the bondholders of the corporation obtained a judgment against the debtor corporation in the amount of 43.56x dollars, which was presumably the amount of the principal and interest due upon the bonds. The property of the corporation was thereupon sold and bid in by the bondholders for 27x dollars. After the property was bid in by the bondholders a new corporation was formed with an authorized stock issue of 20x dollars and the property was exchanged by the bondholders for the total issue of stock in the new corporation and the Advisory Tax Board after quoting the provisions of article 836, Regulations 45 (original edition), that—

No claim will be allowed for a paid-in surplus in \* \* \* respect of property which the stockholders or their agents on or shortly before the date of such payment acquired at a bargain price, as for instance, at a receiver's sale—

stated:

It does not appear that this article is relevant. The stockholders did not acquire the property at a bargain price. The cost of the property to them was an amount which they paid for their bonds in the first instance. The bid price at which title to the property was secured was evidently nominal and did not determine the investment of the new owners in the property.

And based its conclusion that the corporation should be allowed to set up an invested capital equal to the value of the property transferred to the corporation at the date of transfer upon the ground that there had been no change of beneficial interest in the stockholders.

The case considered in T. B. M. 49 was again considered in A. R. R. 857 (not published). The facts in the case are thus briefly stated in T. B. N. 49:

It appears that the Y Company went into the hands of a receiver on November —, 1911, the plant being worth, on the basis of cost less depreciation, approximately 8x dollars. The creditors bought the business at a bankruptcy sale for a price less than their claim. From the memorandum it appears that the number of creditors who purchased this property consisted of five, three of whom were banks. These banks acquired the assets at a receiver's sale at a nominal figure in order to cover loans to the amount of 2.07x dollars. The claims of the other two creditors are not stated. On October —, 1912, the creditors turned the business over to the Z Company, a new corporation formed for the purpose of taking over the property. The conditions of this latter sale were: (1) The Z Company was to supply 6x dollars working capital; (2) the Z Company was to assume the unpaid liabilities of the Y Company and pay them off within a period of 10 years; (3) the Z Company was to have the assets of the Y Company in return for meeting the liabilities.

Upon these conditions the Z Company was duly incorporated with a capital stock of x dollars subscribed. It is claimed that the stockholders of the new corporation are the same as those of the defunct Y Company and for that reason the new corporation requests to be permitted to set up an invested capital equal to that of the defunct corporation.

It also appeared in this case that during the receivership the receiver was ordered by the court to continue the business which he did at a loss of from .08x dollars to .1x dollars; that the successful operation of the company's business necessitated the buying of certain material on long-time contracts with ready cash, as the raw material had to be obtained from foreign countries, requiring six weeks to two months as a rule for delivery; that the receiver upon conferring with 75 per cent of the creditors was required to sell the property and the banks which were the principal creditors, acting through a trustee, bought in the property; that some of the stockholders of the Y Company could not or would not venture new money toward additional capital and the remaining stockholders took the risk and made a further investment of x dollars under an arrangement whereby the property was turned over to the Z Company, subject to the payment by the latter of the claims of the creditors of 2.07x dollars. The Committee at that time also considered a memorandum found with the case, to the effect that \* \* \*: the company's liability for 1917 advised the Bureau orally as follows:

Some time prior to the date the Y Company went into the hands of a receiver, A, the president and majority stockholder, disposed of all of his stock. A was also a director in one of the banks which was a creditor of the corporation. Through this connection he got the bank to call in its loan and thus forced the company into the hands of a receiver. The agent's report shows that A was appointed receiver. —, 1912, the property of the company was sold at a judicial sale to the creditors for the amount of the indebtedness. —, 1912, the O Bank, as trustee for the creditors, sold the property to the Z Company, a corporation organized for that purpose, of which company A was the majority stockholder.

\* \* \*



Upon this evidence the Committee found:

That there was a substantial change of beneficial interest in the property when turned over to the Z Company is clear. The creditors of the Y Company as above indicated, purchased the property at the receiver's sale at a price less than their claims, and when the creditors turned the property over to the Z Company in consideration for the assumption by the latter of the debts owed the creditors of the Y Company, the cost of the property to the Z Company thereby became established. The Committee can not ignore the fact convincingly shown by the record that the parties to this transaction were dealing at arms' length; that the three banks to which was owed 93.70 per cent of the indebtedness assumed by the Z Company did not become stockholders of that company; and that the conduct of the business by the receiver whereby a loss of .08x dollars or .1x dollars was incurred tended materially to decrease the actual value of the property for the purpose of sale between a willing seller and a willing buyer.

\* \* \* In view of the two intermediate transactions between ownership of the property by the Y Company and acquisition by the Z Company, the Committee is of the opinion that the Bureau is precluded by article 63 of Regulations 41, as construed in Solicitor's Memorandum 551 (not published), and by article 836 of Regulations 45, from ascribing to this property for the purpose of computing statutory invested capital a value in excess of its actual cost to the Z Company, and it is recommended that the claim for paid-in surplus for 1917 and 1918 be denied.

It is believed that a careful consideration of the principles involved in these two cases will furnish a satisfactory basis for a determination of the question whether property purchased at a receiver's sale and paid into a corporation is to be deemed to have been acquired at a bargain price and the excess value for that reason excluded from the capital.

Where the assets of a corporation are purchased by its creditors (bondholders or general creditors) at a receiver's sale and are thereafter conveyed by the creditors to a new corporation of which they are the stockholders for a financial consideration, or in consideration for all or substantially all of its capital stock, as in the case cited in T. B. R. 32, the price at which the property is purchased by the creditors is usually nominal, the true cost of the assets to the creditors being the amount of their credits, and in the conveyance to the new corporation there is no substantial change in beneficial ownership but only in the form of ownership. The element of bargaining does not enter into the transaction and if the value of the assets which can be clearly and definitely established is substantially in excess of the consideration paid therefor by the corporation, or of the par value of the stock issued therefor, a paid-in surplus in the amount of such excess may be allowed. If, on the other hand, the property is conveyed by creditors to a corporation in which they do not hold the capital stock or a substantial part of it, as in the case considered in T. B. M. 49, a reasonable regard for human nature compels the conclusion that the property is not conveyed for a consideration substantially less than that for which it could be sold in the market and that the price or the consideration paid therefor fixes the cost of the assets and, therefore, the value to the corporation for the purpose of computing its invested capital.

Whether or not the creditor were stockholders of the old corporation appears to have little or no bearing upon the rules just stated, but if the transaction under consideration took place subsequent to March 3, 1917, the consideration of whether or not the creditor purchasers were also the stockholders of the old corporation becomes material, since, if they were, the transaction would ordinarily constitute a reorganization and the limitation imposed by section 331 of the Act of February 24, 1919, would apply.

In the light of these principles your questions are answered specifically as follows, the substance of the questions being incorporated in the answers to avoid any misunderstanding as to what factors are considered material to be considered:

(a) When the purchasers at a receiver's sale are creditors of the old corporation but are not stockholders in either the old or the new corporation, the price paid for the assets by the new corporation fixes the value of the assets for the purpose of computing its invested capital and no paid-in surplus can be allowed.

(b) When the purchasers are both creditors and the stockholders of both corporations and a value for the assets clearly and substantially in excess of the cash or par value of the stock paid therefor by the corporation, can be definitely and accurately established, a paid-in surplus may be allowed. If, however, the transaction occurred after March 3, 1917, the transaction will ordinarily be held to constitute a reorganization and the limitation imposed by section 331 of the Act of February 24, 1919, will apply.

(c) When the purchasers are the stockholders of both the old and the new corporations but are not creditors of the old corporation, there is no substantial change in the beneficial interests and the cash or other consideration received for the assets from the new corporation does not necessarily measure the value of the assets, and the same rule applies as in case (b). If the transaction occurred subsequent to March 3, 1917, the transaction would ordinarily constitute a reorganization and be governed by section 331 of the Revenue Act of February 24, 1919.

(d) When the purchasers are composed in part of creditors of the old corporation who are not stockholders and in part of stockholders of the new and old corporations, each case must be determined upon its own particular facts in accordance with the principles above stated. If the number of creditor stockholders common to both corporations is sufficiently large so that there is no substantial change of beneficial ownership, the case will fall within the rule laid down in case (b). If on the other hand, a considerable number of the purchasers are not stockholders of the new corporation, it is not to be supposed that they would consent to a sale of the assets for a price materially less than their fair value and, therefore, the price or consideration paid would determine the value of the assets for the purpose of computing invested capital and no paid-in surplus can be allowed.

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II('23)-8-901: A. R. R. 2406

Held, that since the M Company is unable to tie up the inventory as of the date as of which the appraisal was made with the books of the corporation and thus to determine either the date of acquisition or the cost of practically 100 per cent of such inventory, the appraisal submitted is not susceptible of verification within the requirements of T. D. 3367 [¶1265, herein].

The appeal of the M Company from the action of the Income Tax Unit in reducing its invested capital as of date of organization from 158.35x dollars to 63.29x dollars, as the result of rejecting a retroactive appraisal offered in evidence to establish a paid-in surplus was considered by the Committee in A. R. R. 1276 [Number 16, above]. After a thorough consideration of the method in which the appraisal had been prepared the Committee found that it conformed generally to the requirements of T. D. 3367 [¶1265, herein] and recommended that it be accepted as competent evidence subject to check as to individual items by the Unit.

In response to a letter from the Unit calling for the evidence considered necessary to enable it to check this appraisal under T. D. 3367, the duly qualified representative of the appellant stated, under date of December —, 1922:

Paragraph three of your letter of November — asked for dates of acquisition of all items acquired prior to July —, 1914. It is impossible, with the information we have, to

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give you these dates of acquisition on any appreciable amount of the individual items. I can, however, say that the predecessor corporation started business in 1904 and that additions to plant were made quite extensively in 1907, and probably 90 per cent of the plant on hand July —, 1914, was acquired in those two years.

Referring to paragraph four of your letter asking us to segregate the items which are identified with entries on the books of the predecessor corporation from the items not so identified, it would be a long and difficult task to do this in the form you wish. While the prices paid by the predecessor corporation were used wherever possible, they do not constitute a large per cent of the value, and as it is my understanding that these costs would be, in any event, only for comparative purposes, I believe that the values we have used as of July —, 1914, can be checked to your satisfaction in some other way.

In paragraph five you asked for costs of installation, freight, and cartage. These items were in most cases determined by inspection and by conference with the master mechanic of the company and by using the freight rates known to exist at July —, 1914. To give the detail which you asked for would require an expenditure of money far in excess of anything gained by having these items included at the conservative value which I have shown for these items.

In view of the admitted inability of the appellant to furnish the evidence necessary to enable the Unit properly to check the appraisal, the case has been returned to the Committee for further recommendation.

The action of the Unit has been discussed with the representative of the appellant and the case is, therefore, further considered as on appeal.

The replies of the appellant indicate a total failure to tie up the inventory as of the date as of which the appraisal was made with the books of the corporation and thus to determine either the date of acquisition or the cost of practically 100 per cent of such inventory. Under these circumstances the Committee concurs in the position taken by the Unit that the appraisal submitted in this case is not susceptible of verification within the requirements of T. D. 3367 [¶1265 herein].

KINGMAN BREWSTER,

*Chairman Committee on Appeals and Review.*

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II (23)-33-1198: A. R. R. 3572.

### Revenue Act of 1917.

The purchasers at a receiver's sale in 1914 were the stockholders of the bankrupt corporation. Capital stock in a new corporation in the amount of 10x dollars par value was issued to them for the assets purchased. The value of the assets paid in was 23.82x dollars. The new corporation is entitled to a paid-in surplus of 13.82x dollars.

The M Company has appealed from the action of the Income Tax Unit in making certain adjustments of invested capital and income for 1917 which would result in an additional tax in the amount of 1.41x dollars.

The principal question involved in this appeal is the disallowance of 16.49x dollars claimed paid-in surplus. The appellant corporation was organized under the laws of the State of S on September —, 1914, to engage in retailing — and — supplies. A company known as the N Company, owned and operated by the O family, had been engaged in the same business for many years and had gone into the hands of a receiver. On August —, 1914, this receiver sold the stock of merchandise, etc., of the bankrupt concern to one, A, who was acting as agent for the O family, for 6.05x dollars. The O family then paid A 6.1x dollars for these goods. It is claimed on behalf of the appellant company that this merchandise and other assets were turned into the new corporation at a cash value of 23.82x dollars in return for the

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total capital stock of the new corporation, namely, 10x dollars par value. The same assets had been inventoried by the receiver at the time of the sale at 19.61x dollars. All of this stock, except qualifying shares, was issued to B, a member of the O family. It is also claimed that her son, C, who held 1 share of stock, turned over to the new corporation goods of the value of 7.34x dollars not acquired from the bankrupt concern. It does not appear how C acquired this merchandise nor what it comprised. The articles of association dated September —, 1914, show that the capital stock was issued for assets consisting mostly of merchandise and store and office furniture and fixtures in the total amount of 23.82x dollars. The only evidence furnished in support of the claim for that part of the surplus based upon goods turned in by C is the statement that the opening inventory totaled 31.17x dollars and comprised assets paid in for stock valued at 23.82x dollars and the goods in question, valued at 7.34x dollars.

The revenue agent states:

This company bought for cash a bankrupt stock of merchandise and fixtures for 14.68x dollars, as shown by the records; no distribution of the 4.68x dollars has been made by the corporation over the 10x dollars for which the capital stock was issued, this excess has been allowed as paid-in surplus.

In view of the meager data furnished by the appellant company and by the revenue agent, the Committee is of the opinion that the only reliable evidence upon which to base its recommendation is contained in the articles of association, which set forth an itemized description and valuation of the assets actually paid in to the corporation for capital stock. This valuation is believed to be fair. The revenue agent was in error in holding that the corporation itself bought the assets at a receiver's sale and in allowing paid-in surplus of only 4.68x dollars. The company was not incorporated until a month after the sale in question. Under A. R. M. 192 (C. B. II-1, p. 201), the appellant company is entitled to a paid-in surplus in the amount of the difference between 23.82x dollars, value of the assets paid in, and 10x dollars capital stock, or 13.82x dollars. The Committee finds that the claim for a paid-in surplus in excess of this amount has not been established.

The adjustments of income for 1917, including several small changes on account of depreciation, were based upon a field investigation made after the appellant had been notified of the result of an office audit. The appellant objects to a reopening of question which it had considered closed. Sufficient proof to establish these minor claims of the appellant, however, has not been presented, and, accordingly, the Committee concludes that such adjustments of income as were made by the revenue agent and accepted by the Unit are correct.

The Committee, therefore, recommends that the action of the Income Tax Unit in disallowing paid-in surplus in excess of 4.68x dollars be modified to the extent of allowing such surplus in the amount of 13.82x dollars, and that the adjustments of income by the Unit on the basis of the field examination be sustained.

KINGMAN BREWSTER,

*Chairman Committee on Appeals and Review.*



Law Section 326.—Invested Capital (1918 Act—¶555 ante): (1921 Act—¶1035, post).

Article 837.—Surplus and Undivided Profits; Paid-in Surplus (Reg. 45, ¶760, ante): (Reg. 62—¶1193, post).

12-20-801: O. D. 417.

So much of a replacement fund for steamers lost established in accordance with article 50, Regulations 45, as represents excess of the amount of insurance received over the book value of the steamers at the time of their destruction may not be included in invested capital for the purpose of war and excess profits taxes, even though the interest received from the investment of such excess is reported as taxable income, because such excess is not "paid-in or earned surplus" within the meaning of section 326 of the Revenue Act of 1918.

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17-20-882: A. R. R. 70.

#### REVENUE ACT OF 1917.

The principal stockholder of a close corporation invented a certain article and turned over to the corporation his rights to the invention. After some litigation, a patent was granted to the inventor who turned it over to the corporation without consideration. The corporation was engaged in the manufacture and sale of the article both before and since the patent was issued. The questions presented are whether the value of the patent may be included by the corporation in its invested capital for 1917, since it was not paid in for stock but without consideration, and assessment of its excess profits tax for 1917 under section 210 of the Revenue Act of 1917.

Section 207 of the Revenue Act of 1917, defining invested capital, provides for three classes of such capital, following the earlier Act of March 3, 1917, as actual cash paid in, tangible property paid in for stock or shares, and paid in or earned surplus. Then follows a proviso not contained in the Act of March 3, 1917, providing for two classes of property as to the classification of some items of which there has been, in the courts of the country, considerable dispute. The first provides that the actual cash value of patents and copyrights paid in may be included in invested capital not to exceed the par value of stock issued therefor; the second provides that good will, trade-marks, trade brands, etc., may be taken into invested capital only to a limited extent as intangible property. It will be seen by this division that Congress manifestly intended in the Revenue Act of 1917, to classify patents and copyrights as tangible property and trade-marks, good will, and other property as intangible; and it also provided that where patents were turned in *for stock* the figure at which they could be taken into invested capital is the actual cash value or the par value of the stock issued therefor, whichever is lower, but this does not necessarily preclude the recognition of actual value of patents turned in as paid-in surplus.

The Committee is therefore of the opinion that under the Revenue Act of 1917, the corporation would be entitled, upon establishing the value of the patent turned over to the company without consideration, to include such value as invested capital. In the present case, however, it is apparent that the inventor turned over to the company the rights to his invention long prior to the issuance of letters patent covering same, in fact, immediately after the invention of the device. The amount which could be recognized, therefore, as paid in surplus would be the value of the invention at the time it was

turned over to the company and before commercial development rather than its value when letters patent were issued and at which time development had proceeded sufficiently to possibly justify the valuation claimed by the company. What that value was at the time of the invention, is in the judgment of the Committee, a fact which can not be satisfactorily determined, and it seems clear that it would be impossible to prove a value at that time in excess of the value given to it in practical effect by the application of section 210; that is to say, the difference between the statutory capital and the constructed capital under that section.

The Committee is therefore of the opinion that the action of the Income Tax Unit in assessing the tax under the provisions of section 210 was proper and works no injustice upon the taxpayer.

For the same reasons that section 210 was applied under the 1917 Act, it is recommended that the company be assessed for 1918 and subsequent years under the provisions of sections 327 and 328 of the Revenue Act of 1918.

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19-20-925: A. R. R. 86.

## REVENUE ACT OF 1917.

Held in the appeal of the M Company that a claim for paid-in surplus in 1917 can not be allowed in the case of appreciated value in a leasehold which was acquired by the company as original lessee without cost and which was not paid in at a fixed value for stock or shares.

The M Company has appealed from the decision of the Income Tax Unit in connection with its income and excess profits tax for 1917. Amended returns were filed by the company, in which the invested capital for 1917 was increased by including therein as paid-in surplus the appreciated value of a lease, which was acquired by the company as original lessee, and which was not paid in for stock or shares in such company. This leasehold was not carried as an asset by the company, and was not entered on its books until 1918.

It appears that subsequent to the time of filing its return, and during the early part of 1919, the company had an appraisal made for the purpose of fixing the value of this leasehold. This appraisal furnishes estimated values as at the time of the renewal of the lease in 1916, and values for years subsequent thereto. The company claims in its presentation of the case that article 63 of Regulations 41 permits the inclusion in invested capital as paid-in surplus the appreciated value of the leasehold as ascertained by the appraisal. The original lease, which was acquired without cost, carried an option of renewal, which was exercised by the company in 1916. This renewal, under the option of the original lease, was obtained without cost.

The term "invested capital" as used in the excess profits tax law for 1917 means the invested capital of the present owner. The starting point in the computation of invested capital is the amount of cash and other property paid in. In the ascertainment of the correct invested capital, surplus and undivided profits are taken into consideration, and also depletion, depreciation, or obsolescence of the property originally acquired for cash, or for stock or shares, or in any other manner.

The taxpayer relies on the provisions of article 55 of Regulations 41, reading as follows:

Tangible property paid in for stock or shares prior to January 1, 1914, must be valued at either (a) the actual cash value of such property on January 1, 1914, or (b) the par value of the stock or shares specifically issued therefor, whichever is lower. This is one



of the few cases in which the law permits allowance to be made for appreciation, and here no appreciation can be recognized unless the original stock or shares were specifically issued in exchange for such tangible property.

Tangible property paid in for stock or shares on or after January 1, 1914, will be taken at the actual cash value of such property at the time of payment, irrespective of the par value of the stock or shares.

The taxpayer also relies on the provisions of article 63, which reads as follows:

Where it can be shown by evidence satisfactory to the Commissioner of Internal Revenue that tangible property has been conveyed to a corporation or partnership by gift or at a value, accurately ascertainable or definitely known as at the date of conveyance, clearly and substantially in excess of the cash or the par value of the stock or shares paid therefor, then the amount of the excess shall be deemed to be paid in surplus. The adopted value shall not cover mineral deposits or other properties discovered or developed after the date of conveyance, but shall be confined to the value accurately ascertainable or definitely known at that time.

Evidence tending to support a claim for a paid-in surplus under these circumstances must be as of the date of conveyance, and may consist, among other things, of (1) an appraisal of the property by disinterested authorities, (2) the assessed value in the case of real estate, and (3) the market price in excess of the par value of the stock or shares.

The Committee in the consideration of this case has applied the law to the statement of facts and is of the opinion that the instant case does not fall within the provisions of articles 55 and 63 as contended by the taxpayer.

The articles of the regulations quoted above are specific and correctly interpret the statute. The taxpayer, by its admission, bars any claim for paid-in surplus. The company having acquired the leasehold as original lessee without cost and later renewing same without cost had nothing which could be paid in for stock or shares. Any value appreciation in such leasehold must be eliminated from the computation of invested capital.

3

40-20-1227: A. R. R. 233.

#### REVENUE ACT OF 1917.

The committee has had under consideration the appeal of the M Company, from the action of the Income Tax Unit in assessing additional tax based upon the disallowance of a portion of the company's claim for invested capital.

The facts with regard to this case appear to be that the plant of the M Company is located some miles from a railroad or other transportation facilities, and that it is, therefore, dependent for its supply of raw material upon the product raised in the vicinity. The plant has a capacity of approximately 2y tons, which is about the production of the tributary territory. Of this 2y tons, y tons are produced by several large plantation owners, the other y tons being produced by plantations owned by the company itself, and by small farmers. The transportation conditions are such, as before stated, that the plant can be operated successfully only if it obtains the entire output of the vicinity.

In 1912, the manager of the corporation which has been operating this plant died, and some differences arose between the large plantation owners and the owners of the plant. The plantation owners who were dissatisfied made tentative arrangements for the erection of a smaller plant intended to produce the finished article on a co-operative basis, only utilizing the raw material which they produced. As the old company could not operate economically upon what was left of the field's production, it became at once involved in financial difficulties, with the result that the holder of a

mortgage on the property, foreclosed it, the old manufacturing company thus becoming defunct. Negotiations were thereupon opened between this creditor and the plantation owners for the sale of the plant to a new corporation to be formed by them. These negotiations were finally completed by the organization of a company with a capital stock of  $7x$  dollars,  $6x$  dollars of which was paid in in equal shares in cash by the plantation owners, and the other  $x$  dollars was issued to the negotiator for his services in organization. The plant was transferred to the new corporation in consideration of the company's notes secured by mortgage upon the plant, and in consideration of the agreement that the owners would each individually contract with the new corporation to sell to it all of his product for a period of five years, the period during which the purchase money notes would mature. It is claimed that by reason of the bringing together of the plant, which shortly before foreclosure was appraised at  $200x$  dollars, and the contracts for raw material, that the plant was at once restored to its appraised value, and that these contracts made with the company were so closely related to rights in the tangible property, to-wit, the plant, as to constitute contracts recognizable as tangible property within the meaning of article 811, justifying treatment of them as paid-in surplus. The difficulty with this argument is that it is based upon a false premise. Paid-in surplus, as its name implies, must be some tangible property transferred from the owners to a corporation, either as a gift or at a value less than the actual cash value of the property transferred, and in practically all cases where allowable, involves no substantial change in beneficial interest. In this case, the plant itself was not transferred to the company as a gift or for stock, but was bought by the company from an owner, not a stockholder in the company, for its notes, which notes have subsequently been paid off through earnings. Neither can contracts made with the company itself, and to which it is one of the parties, be held to be paid-in surplus. Contracts in any event, and where they may be regarded under the regulations as tangible assets, can only constitute paid-in surplus if the contracts were made between outside parties and the rights of either of those parties is then transferred to a corporation without adequate compensation.

The Committee is, therefore, compelled to recommend that the claim for paid-in surplus be rejected.

4

47-21-1936: A. R. R. 678.

Recommended, in the appeal of the M Company, that the action of the Income Tax Unit in denying the right to include in the computation of invested capital as paid-in surplus  $3\frac{1}{4}x$  dollars, representing claims owed to and canceled by creditor stockholders, be reversed, and accordingly that the taxpayer's appeal be sustained.

The Committee has had under consideration the appeal of the M Company from the action of the Income Tax Unit in holding that an item of  $3\frac{1}{4}x$  dollars may not properly be treated as paid-in surplus for the purpose of computing invested capital.

A review of the record in the case discloses the following relevant facts which do not appear to be disputed. The M Company was incorporated in 190— with a paid-in capital of  $5x$  dollars, and since that time has undergone no corporate change; and in 1913 stockholders, with claims amounting to  $3\frac{1}{4}x$  dollars for goods and materials furnished to the company in the course of business, canceled their claims. It appears that the company was originally organized in 190— by the heirs of A, the founder of the business, and



that his son had control of the business until 1913; further, that the company operated consistently at a loss up to 1913, when it was placed in the hands of a receiver, at which time it was rehabilitated without corporate reorganization through the transfer of capital stock to creditors. It is shown that creditors' claims amounting to  $3\frac{1}{4}x$  dollars were, as before stated, canceled, and at the same time there was a transfer to said creditors of  $3x$  dollars par value of the company's capital stock from the members of A's family; also further shares were transferred and sold to obtain financial aid necessary to place the company and its business on a working basis. As a result of such transfers, the control of the corporation since 1913 has been in the hands of B and C, of the O Company. These two individuals, it appears, were the principal creditors of the appellant company at the time receiver was appointed.

It is the claim of the corporation that the amount of debts so canceled constitutes a contribution of new capital invested by the creditors to the extent of their canceled claims.

The view expressed by the Unit in its memorandum of February 16, 1921, is substantially as follows:

Inasmuch as the creditors received stock for the cancellation of their claims, it was the opinion of the representatives of the Bureau that the amount involved did not constitute paid-in surplus within the meaning of the law.

Upon consideration of the foregoing, it appears to the Committee that at a time just prior to the receivership the appellant company's invested capital was  $5x$  dollars, provided that the par value of the total capitalization of the company was fully paid in at the time of organization, and this is true despite the fact that at a time just prior to the receivership the company showed a large operating deficit. In this connection attention is called to the fact that the Bureau has consistently held that the original amount of capital paid in for stock subscriptions shall never be reduced for purposes of computing invested capital by reason of an operating deficit. Conceded, then, that the invested capital at a time just prior to the receivership in 1913 was  $5x$  dollars, what effect, if any, had the stock transactions between stockholders upon invested capital? The Committee can see no change in invested capital resulting thereby. The transfer of stock between the several stockholders of the corporation or between stockholders and persons who have not prior to such action been stockholders, whether for a valuable consideration in excess of or less than the par value or market value of the corporate stock, or for no consideration whatsoever, can, in the opinion of the Committee, have no effect upon the measure to be assigned to the original paid-in capital for the purpose of computing invested capital.

It is pointed out in the instant case that the principal creditors of the corporation at the time of the receivership received by transfer from the majority stockholders  $3x$  dollars par value of the capital stock. It does not appear whether a consideration of any description entered into this transaction. However, the Committee can see no possible effect which such transaction could have upon the original paid-in capital for the purpose of determining invested capital.

With respect to the cancellation of the claims of creditors who were themselves stockholders and assumed control by reason of the transfer aforesaid, it is the opinion of the Committee that such action clearly resulted in an additional contribution to capital which assumed the character of paid-in surplus. The situation seems to be that these stockholders made numerous advances either in money or money's worth to the corporation which gave rise to an existing liability constituting a charge against the corporate assets.

By the cancellation of such claims a condition arose whereby the corporate liabilities were correspondingly reduced and the assets correspondingly increased.

It is true that this action on the part of said stockholders effected no change in the corporate surplus for the reason that an operating deficit existed. However, the applicable rule in this connection is found in article 860 of Regulations 45, which provides in part that:

Capital or surplus actually paid in is not required to be reduced because of an impairment of capital in the nature of an operating deficit.

A careful study of the above matters leads the Committee to conclude that the cancellation by stockholders of  $3\frac{1}{4}x$  dollars of claims owing to such stockholders resulted in effect in an additional contribution to the corporation's capital account which assumed for the purposes of invested capital the nature of paid-in surplus; further, that this is true regardless of any transfers of stock as between the stockholders which may or may not have been a consideration moving to the cancellation of said claims.

It follows obviously that the corporation's invested capital is at least the  $5x$  dollars fully paid-up capital as it existed just prior to the receivership, plus the  $3\frac{1}{4}x$  dollars paid-in surplus, which was effected by reason of the cancellation of the stockholding creditors' claims, or a total of  $8\frac{1}{4}x$  dollars. Therefore, it is recommended in the appeal of the M Company that the action of the Income Tax Unit in denying the right to include in the computation of invested capital as paid-in surplus  $3\frac{1}{4}x$  dollars representing claims owed to and canceled by creditor stockholders be reversed, and accordingly that the taxpayer's appeal be sustained.

5

II ('23)-22-1074: A. R. R. 2971.

### Revenue Act of 1917.

Property was held in trust for a corporation and at the end of the trust period was to be conveyed to the corporation, provided all the conditions set out in the agreement had been complied with. At any time during the continuance of the trust the property would have reverted for failure to comply with the conditions. It may not be included in invested capital until full compliance with the terms of the agreement.

The Committee has had under consideration the appeal of the M Company from the action of the Income Tax Unit in excluding from invested capital for 1917 certain cash and tangible property used in the business under the terms of an agreement entered into February 7, 1911.

In the year 1911 the appellant entered into a joint agreement with the N Company and the O Company under the terms of which the N Company agreed to contribute  $15x$  dollars in cash to be used in building a factory for the appellant in the city of S, and the O Company agreed to contribute land of the value of  $5x$  dollars on which factory was to be erected. The agreement also provided that the appellant was to invest in the factory buildings, etc., not less than  $15x$  dollars and operate the factory for a period of 10 years, during each year of which time not less than 100 male employees were to be employed. The agreement further provided that if before title had been conveyed to the appellant it should abandon or cease to operate said factory or fail to perform any and all of its other obligations under the agreement, then it should forfeit all of its rights and interest in and to the said land and the buildings and permanent improvements that may have been placed thereon and should have no further interest therein and would, upon demand, vacate and surrender the property. During the 10 years



the property was to be held in trust by the N Company and at the expiration of the period was to be conveyed to the appellant by a good and sufficient deed, provided all of the conditions set out in the agreement of 1911 had been complied with. The contract was carried out and in the year 1921 the land and buildings were deeded to the taxpayer and a release given by the N Company for any and all contractual rights which it held under the agreement.

The appellant contends that for all practical purposes the cash and land were paid into the corporation for use in its business without any financial consideration or interest charges, and that the 20x dollars should be allowed as paid-in surplus under the provisions of article 63 of Regulations 41.

The Committee has carefully considered the arguments that have been advanced and has reached the conclusion that under no construction of the regulations could this cash and tangible property be regarded as having been paid in to the appellant corporation at any time prior to the full compliance with all of the terms of the agreement entered into in 1911. The appellant corporation could, at any time during this period, have failed or refused to comply with one or more of the conditions, and had this been done all of the property would have reverted to the N Company. The provisions of the law and regulations relating to paid-in surplus do not contemplate any such contingent interest with respect to the property paid in.

It is therefore recommended, in the appeal of the M Company, that its claim for paid-in surplus of 20x dollars be denied and that the action of the Income Tax Unit be sustained.

KINGMAN BREWSTER,  
*Chairman Committee on Appeals and Review.*

6

II(23)-27-1131: I. T. 1802.

### Revenue Acts of 1917 and 1918.

When a corporation purchased its own stock at a price below the paid-in value of the shares it acquired, the amount paid out by the corporation represented a return of paid in capital, and the difference between the amount paid by the corporation and the paid-in value of the shares represented paid-in surplus, and earned surplus was not affected by the transactions.

When a premium was paid in retiring other shares of the capital stock, the amount thereof should be charged first to earned surplus accumulated prior to March 1, 1913, and secondly to earned surplus accumulated subsequently to February 28, 1913.

A corporation purchased shares of its own stock from one of its stockholders at a price which was less than par which represented the value of the assets paid in for such stock, and also purchased other shares from the executrix of a deceased stockholder. The agreement with reference to the purchase of the stock from the executrix provided that the estate should be paid x per cent of the amount which the decedent would have been entitled to receive as a shareholder for the three calendar years 1922, 1923, and 1924 had he lived and continued to be a stockholder in the corporation with the same interest he held at the time of his death.

Held, for the purpose of the Federal income tax the purchase by a corporation of its own stock first reduces its paid-in capital, whether such paid-in capital consists of tangible or intangible assets. Accordingly, when the corporation purchased its own stock at a price below the paid-in value of the shares it acquired, the amount paid out by the corporation represented a return of paid-in capital, and the difference between the amount paid by the

corporation and the paid-in value of the shares represented paid-in surplus, and earned surplus was not affected by the transactions.

The amount paid to the executrix of the deceased stockholder, together with the payments to be made to the estate out of the profits for the years 1922, 1923, and 1924 should be treated as a return of paid-in capital to the extent of par value of the shares purchased. If, however, it results that a premium is paid in retiring such stock the amount thereof should be charged first to earned surplus accumulated prior to March 1, 1913, and secondly to earned surplus accumulated subsequent to February 28, 1913.

7



**Law Section 326.—Invested Capital (1918 Act—¶555, ante): (1921 Act—¶1035, post).**

**Article 838.—Surplus and Undivided Profits; Earned Surplus (Reg. 45—¶761, ante): (Reg. 62—¶1194, post).**

1-19-121: O. D. 82.

Good will created to offset impaired capital has no effect on invested capital. Subsequent earnings must be used first to restore impaired capital; excess may be added to original investment as invested capital.

1

1-19-130: O. D. 91.

Any portion of surplus or undivided profits representing unearned interest or discount which has not been reported as taxable income, must be excluded in the computation of invested capital for war profits and excess profits purposes.

2

1-19-131: O. D. 92.

If a taxpayer reports profits on installment sales on the basis of the proportionate part of each installment received representing profit, his surplus account as at the beginning of the taxable year must be reduced in computing invested capital to the extent that the surplus account includes profit on such sales which has not been reported as taxable income.

3

22-19-538: T. B. R. 67.

*Revenue Act of 1917.*—Treatment, for the purpose of determining the invested capital of a domestic corporation, of shares of stock in a foreign corporation deriving no income from sources within the United States, acquired for cash and in exchange for a patent right.

The M Company, a domestic corporation, organized the O Company a foreign corporation. The O Corporation issued stock of the par value of 10x dollars to the M Corporation for 5x dollars cash and for the right to use certain patents, which right was worth at least 5x dollars. None of the income of the O Corporation for the year 1917 was derived from sources within the United States. The question is as to the method of treatment of the shares of stock of the O Corporation in determining the invested capital of the M Corporation for the year 1917, under the Revenue Act of that year.

In computing the surplus and undivided profits of the M Company the shares of stock in the O Corporation are to be valued at cost, with proper adjustments, if any. (The method of computing surplus and undivided profits under the Revenue Act of 1918, laid down in article 838 of Regulations 45, is equally applicable to the computation of surplus and undivided profits under the Revenue Act of 1917.) In the cost of the shares of stock of the O Corporation are to be included the cash payment of 5x dollars, and the patent right at its value at the time of the exchange, which value can not be taken as exceeding the value of the shares of stock received in exchange therefor. The effect of the transaction may be to increase or decrease the

amount of the surplus and undivided profits of the M Corporation, though the assets which ultimately give value thereto; to wit, the cash and the patent right, remain the same. Such increase or decrease, however, is due to such a change in the situation as amounts to a realization of gain or loss, and any gain so realized is earned surplus, as any loss so realized effects a decrease in earned surplus. (See Art. 1565, Regs. 45, as amended by T. D. 2924.) Since earned surplus is considered in determining invested capital regardless of the time when it was earned, it is immaterial that the gain or loss realized from the transaction was due to appreciation or depreciation which in part occurred prior to March 1, 1913. In this respect the principles applicable to the computation of invested capital differ from those applicable to the determination of taxable income for, while such part of the realized appreciation, if any, as is attributable to the period after March 1, 1913, is taxable income, such part as is attributable to the period before March 1, 1913, though considered in the computation of invested capital, escapes taxation.

The shares of stock of the O Corporation constitute "admissible assets" of the M Corporation for the year 1917. The O Corporation derived no income from sources within the United States, and consequently was not subject to income tax under Title I of the Revenue Act of 1916, as amended by the Revenue Act of 1917. (Sec. 10.) The dividends received by the M Corporation upon its stock in the O Corporation should, therefore, be included in the income of the M Corporation for purposes of the excess profits tax. They are not "amounts received \* \* \* as dividends upon the stock \* \* \* of other corporation \* \* \* subject to the tax imposed by Title I of such act of September 8, 1916," within the meaning of section 206 of the Revenue Act of 1917 which authorized the deduction of such amounts from the income of a domestic corporation in order to determine the amount of income of such corporation subject to the excess profits tax. Consequently, the stock of the O Corporation does not constitute "inadmissible assets" under the provision of section 207 of Title II of the Revenue Act of 1917 that—

As used in this title "invested capital" does not include stocks, bonds (other than obligations of the United States), or other assets, the income from which is not subject to the tax imposed by this title.

It is held, therefore, that for the purpose of determining the invested capital of the M Corporation (a) in computing its surplus and undivided profits its shares of stock in the O Corporation are to be valued at cost with proper adjustments, if any, such cost being 5x dollars plus the value at the time of the exchange therefor of the patent rights owned by the M Corporation; and (b) such shares of stock are to be regarded as "admissible assets."

18-20-906: A. R. R. 71.

The Committee is of the opinion that appreciation is in no event a part of earned surplus and therefore can not offset depreciation in the value of assets through wear, tear, and exhaustion. Depreciation must first be figured in order to determine true earned surplus. In other words, earned surplus is believed to consist of realized gains or profits and while such realized gains or profits must be reduced by any depreciation in value through use or exhaustion of the assets in which they are invested, any appreciation in value of those assets which is not yet realized can not be taken into consideration for the purpose of offsetting such decrease.

A corporation owns patents covering certain inventions made by its em-



employees. The cost of securing the patents and the salaries of the employees whose inventions were patented were paid by the corporation and charged to expense account. The corporation may not include in its invested capital any amount representing either the cost of the patents or appreciation in their value.

5

29-20-1081: A. R. M. 71.

Advice is requested as to the proper treatment of credit balances of stockholders' accounts in the case of the M Company.

The facts appear to be that no formal declaration of dividends has been made by this company, but a book entry has been made noting and crediting to each stockholder the share of each year's earnings to which he would be entitled under a dividend declaration, the individual shareholders having returned their shares of such earnings in their personal returns and paid the income tax thereon.

Reference is made to Appeals and Review Recommendation 102 as supporting the view that balances to the credit of individual stockholders are not invested capital. In that case, however, the balances standing to the credit of individual stockholders were not in proportion to their stockholdings, whereas it appears in the present case each stockholder has been credited with the amount of the earnings attributable to his stock. No interest has been or is to be paid upon the amounts standing to the credit of these stockholders, no formal declaration of a dividend has been made by the board of directors, and it appears that under the State law the stockholders do not rank with general creditors with respect to such credits.

Under these circumstances the case is clearly distinguishable from the one covered by Recommendation 102, and in the judgment of the Committee the amounts so credited should be regarded as being a part of the earned surplus of the corporation to be included in invested capital.

22-21-1667: A. R. R. 517.

#### REVENUE ACT OF 1917.

Recommended, in the appeal of the M Company, that a mining corporation, in computing its invested capital for the purpose of the war excess profits tax, be required to reduce its earned surplus by the amount of its sustained depletion to the beginning of the year for which the tax is computed; and, under normal conditions, to inventory its metals on hand and not sold at the close of its annual accounting period, at cost or cost or market, whichever is lower.

The Committee has had under consideration the appeal of the M Company from the action of the Income Tax Unit in holding that the surplus earnings of the taxpayer at the beginning of the taxable year 1917, amounting to 16½x dollars, which the company claimed as a part of its invested capital for the taxable year, and which represented the undistributed accumulations of mining and incidental profits during several years, are overstated to the extent of 9½x dollars; and from the expressed purpose of the Unit to revise the valuation of the taxpayer's inventory of metals on hand at the beginning of the year 1917.

The questions involved being wholly ones of law, the case was referred to the Solicitor of Internal Revenue for his consideration, and his conclusions are quoted below:

You present for consideration the questions whether the M Company is required, in computing its invested capital for the purpose of the war excess profits tax imposed by the Revenue Act of 1917, to reduce the amount of its earned surplus by the amount of any sustained depletion to the beginning of the year for which the tax is computed, and whether it is permitted to inventory metals on hand at the date of the inventory, and not sold, at the selling price.

Section 207 of the Revenue Act of 1917 provides in part that:

As used in this title "invested capital" does not include stocks, bonds (other than obligations of the United States), or other assets, the income from which is not subject to the tax imposed by this title nor money or other property borrowed, and means, subject to the above limitations:

(a) In the case of a corporation or partnership: (1) Actual cash paid in, (2) the actual cash value of tangible property paid in other than cash for stock or shares in such corporation or partnership at the time of such payment (but in case such tangible property was paid in prior to January first, nineteen hundred and fourteen, the actual cash value of such property as of January first, nineteen hundred and fourteen, but in no case to exceed the par value of the original stock or shares specifically issued therefor), and (3) paid in or earned surplus and undivided profits used or employed in the business, exclusive of undivided profits earned during the taxable year: \* \* \*

Section 10 of the Revenue Act of 1916, as amended by section 1206 of the Revenue Act of 1917, provides:

(a) That there shall be levied, assessed, collected, and paid annually upon the total net income received in the preceding calendar year from all sources by every corporation \* \* \* organized in the United States, no matter how created or organized, \* \* \* a tax of two per centum upon such income; and a like tax shall be levied, assessed, collected, and paid annually upon the total net income \* \* \*.

Section 13 (d) of the Revenue Act of 1916, which was not modified by the Revenue Act of 1917, provides that:

A corporation, joint-stock company or association, or insurance company, keeping accounts upon any basis other than that of actual receipts and disbursements, unless such other basis does not clearly reflect its income, may, subject to regulations made by the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, make its return upon the basis upon which its accounts are kept, in which case the tax shall be computed upon its income as so returned.

The X mine was discovered prior to 1883. The N company was organized with a capitalization of  $3x$  dollars to develop and operate the mine. In 1886 additional capital was put into the development of the mine and from that time it has proved immensely profitable, in 1889 the profits, without allowing for depletion, amounting to approximately  $4x$  dollars. In 1900, the M Company acquired, through purchase, the mines and works of the N Company; also the entire issue of the stocks and bonds of the O Company; also all of the real and personal property of the N Company, comprising lands, mining claims, buildings, machinery, tools, ore on dumps and in the works, and supplies and stores of all kinds; also the right to receive what was paid in the distribution of the remaining assets of the N Corporation in dissolution.

The consideration paid by the M Company for the above property was (a) the issue and delivery of its capital stock consisting of  $y$  shares, par value of \$10 per share, (b)  $3x$  dollars of its income bonds in exchange for the transfer of  $x$  dollars of the cash assets of the N Corporation, and (c) the assumption of all contracts, debts, and obligations of the N Corporation, amounting, as shown by the accounts, to  $1-7x$  dollars.

Upon the evidence filed the Income Tax Unit allowed the M Company a paid-in surplus as of the date of its organization in 1900 of  $23\frac{1}{2}x$  dollars, giving it an invested capital of  $26\frac{1}{2}x$  dollars. At the beginning of the taxable year 1917 the company had on hand surplus earnings to the amount of  $16\frac{1}{2}x$



dollars. In its return for the year 1917 the company deducted from its invested capital the sum of  $11\frac{1}{2}x$  dollars, being the amount of the deductions for depletion allowed it under the Act of October 3, 1913, and the Act of September 8, 1916. The Bureau claims that the amount of the deductions should be increased by  $9\frac{1}{2}x$  dollars, making a total deduction of  $11x$  dollars, the amount of the sustained depletion from the date of the acquisition of the property to 1917, based upon the original capital investment value of  $26\frac{1}{2}x$  dollars.

At the close of the year 1917 the M Company had on hand some 20z pounds of metals produced during that year, which it valued on a basis of cost of production. At the close of the year 1916 the company had on hand some 14z pounds of metals ready for sale, some of which had already been sold for future delivery, and following the method, which it alleges it had consistently followed since 1902, it valued all such metals in its closing inventory for the year 1916 at the prices actually obtained for the metals sold (about 40 per cent of the whole), and the prices which, it was estimated, could be counted upon for the remainder of such metals, less the cost of marketing.

In making its return for 1917 the company protested against being required to value at cost its inventory of bullion and contended that it should be allowed to continue its long established accounting method and value its inventory of metals on hand at the end of the year 1917 on the basis of the value to a going concern, to wit, at prevailing selling prices.

The questions presented will be considered in the order in which they were stated.

Article 42 of Regulations 41, relative to war excess profits tax imposed by the Revenue Act of 1917, provides:

The term "invested capital" as used in the excess profits tax law means the invested capital of the present owner. The basis or starting point, in the computation of invested capital is found in the amount of cash and other property paid in, the original values of such other property being determined in accordance with the rules laid down in these regulations. But the computation does not stop with such original entries or amounts; it must take properly into account the surplus and undivided profits. In the computation of surplus and undivided profits, however, full recognition must first be given to expenses incurred and losses sustained from the original organization of the business concern down to the taxable year, including among such expenses and losses a reasonable allowance for depletion, depreciation, or obsolescence of property originally acquired for cash or for stock or shares or in any other manner. \* \* \*

Article 64 of Regulations 41 provides that:

Where, through failure to provide for depletion, depreciation, obsolescence, or other expenses or losses, or where for any other cause or reason the books of account of the taxpayer do not show the true paid-in or earned surplus and undivided profits, in the computation of invested capital such adjustments shall be made as are necessary to arrive at a statement of the correct amount. \* \* \*

(5) The taxpayer shall also show that adequate provision has been made for the depletion, depreciation, or obsolescence of such of the assets so acquired as are, under the rulings of the department, subject to recognized depreciation.

Regulations 45 (1920 edition), construing the very similar provision of the Revenue Act of 1918, provide (article 838):

Only true earned surplus and undivided profits can be included in the computation of invested capital, and if for any reason the books do not properly reflect the true surplus such adjustments must be made as are necessary in order to arrive at the correct amount. In the computation of earned surplus and undivided profits full recognition must first be given to all expenses incurred and losses sustained from the original organization of the corporation down to the taxable year, including among such expenses and losses reasonable allowance for depreciation, obsolescence, or depletion of property (irrespective of the manner in which such property was originally acquired), and for the amortization of any discount on its bonds. There can, of course, be no earned surplus or undivided profits until any deficit or impairment of paid-in capital due to depletion, depreciation, expense, losses, or any other cause has been made good. \* \* \*

Article 839 of Regulations 45 (1920 edition) further provides that:

Depletion, like depreciation, must be recognized in all cases in which it occurs. Depletion attaches to each unit of mineral or other property removed, and the denial of a deduction in computing net income under the Act of August 5, 1909, or the limitation upon the amount of the deduction allowed under the Act of October 3, 1913, does not relieve the corporation of its obligation to make proper provision for depletion of its property in computing its surplus and undivided profits.

This article is equally applicable under the Act of 1917.

It is contended by the taxpayer that, owing to the peculiar character of mining properties, there is no depletion so long as "discovery and development outrun depletion," and that any actual prior depletion is taken care of by the provision for the valuation of tangible property paid in as of January 1, 1914.

The peculiar character of mining property was well stated in *Stratton's Independence v. Howbert*, 231 U. S. 399, 413, as follows:

The peculiar character of mining property is sufficiently obvious. Prior to development it may present to the naked eye a mere tract of land with barren surface, and of no practical value except for what may be found beneath. Then follow excavation, discovery, development, extraction of ores, resulting eventually, if the process be thorough, in the complete exhaustion of the mineral contents so far as they are worth removing. Theoretically, and according to the argument, the entire value of the mine, as ultimately developed, existed from the beginning. Practically, however, and from the commercial standpoint, the value—that is, the exchangeable or market value—depends upon different considerations. Beginning with little, when the existence, character, and extent of the ore deposits are problematical, it may increase steadily or rapidly so long as discovery and development outrun depletion, and the wiping out of the value by the practical exhaustion of the mine may be deferred for a long term of years.

This statement contains the answer to the contention of the taxpayer. The reason that in the case of mines the Supreme Court has consistently held that no deduction for depletion or depreciation in computing net income can be allowed, in the absence of statutory authority, is that by reason of the fact that discovery and development may outrun depletion there is not necessarily any actual decrease in the value of the taxpayer's property, and, therefore, the entire net receipts may well be considered income. The rule is not new but has come down to us from the common law of England. This, however, does not negative the fact that the removal of each ton of ore depletes pro tanto the ore originally known to exist in the mine and which was originally valued. The maintenance or increase of the original value is solely due to the fact that the loss of value through depletion is equalled or exceeded by the appreciation in value through discovery or development. To treat the entire net income as earnings and as constituting earned surplus in the succeeding year when not distributed by the company would, therefore, to the extent of the depletion actually sustained during the year, be to permit the inclusion of appreciation in the value of the mine, by reason of development and discovery, in invested capital, a thing which is not contemplated by the statute nor permitted by the regulations. This was clearly pointed out in Tax Reviewer's Memorandum of January 29, 1919, approved and followed in Law Opinion 753 (not published in the Bulletin Service).

While the provision in section 207(a) for the inclusion in invested capital of the actual cash value as of January 1, 1914, of tangible property paid in prior to that date permits the inclusion of appreciation up to the par value of the capital stock for which such property was paid in (see article 55, Regulations 41), it clearly contemplates that in valuing the property as of that date any depletion or depreciation shall have been made up out of earnings, and, therefore, such a valuation does not involve a second deduction for depletion.

Regulations 33, revised, construing the Revenue Act of 1916 as amended by the Revenue Act of 1917, contains no provision relating to inventories of



mining companies, but article 91 governing inventories by manufacturing corporations, to which mining companies are closely analogous, provides that:

Gross income for the purpose of returns of manufacturing companies shall consist of the total sales plus the inventory at the end of the year less the sum of the cost of goods or materials purchased during the year and the inventory at the beginning of the year. Instructions as to how inventories shall be taken will be included in special regulations to be furnished upon application to the collector of internal revenue \* \* \*

The special regulations referred to are contained in Treasury Decision 2609, which provides in part as follows:

(1) For the purposes of income and excess profits tax returns, inventories of merchandise etc., and of securities will be subject to the following rules:

A. Inventories of supplies, raw materials, work in process of production, and unsold merchandise must be taken either (a) at cost or (b) at cost or market price, whichever is lower, provided that the method adopted must be adhered to in subsequent years, unless another be authorized by the Commissioner of Internal Revenue.

The regulations relating to inventories under the Revenue Act of 1918 (Regulations 45, 1920 edition), are much more extensive but are general and equally applicable under the Acts here considered. Article 1581 of these regulations provides in part that:

Title to the merchandise included in the inventory should be vested in the taxpayer and goods merely ordered for future delivery and for which no transfer of title has been effected should be excluded. The inventory should include merchandise sold but not shipped to the customer at the date of the inventory, together with any merchandise out upon consignment, but if such goods have been included in the sales of the taxable year they should not be taken in the inventory. \* \* \*

Article 1582 provides that:

Inventories must be valued at (a) cost or (b) cost or market, as defined in article 1584, as amended, whichever is lower. \* \* \*

Article 1584 provides that:

Under ordinary circumstances, "market" means the current bid price prevailing at the date of the inventory for the particular merchandise in the volume in which ordinarily purchased by the taxpayer, and is applicable in the cases (a) of goods purchased and on hand, and (b) of basic elements of cost (materials, labor and burden), in goods in process of manufacture and in finished goods on hand; exclusive, however, of goods on hand or in process of manufacture for delivery upon firm sales contracts at fixed prices entered into before the date of the inventory, which goods must be inventoried at cost. \* \* \*

This article also provides for valuing goods in process of manufacture and finished goods on hand at sales price where "owing to abnormal conditions, the taxpayer has regularly sold such merchandise at prices lower than the current bid price as above defined." But this provision can have no application in the instant case since the evidence shows that the M Company at the close of the year 1917 was selling its copper at prices which included abnormally large profits.

Under these regulations a mining company is required to inventory all metals on hand at the date of the inventory, including goods sold but not shipped to customers, at cost, or cost or market whichever is lower, except in the case of metals on hand for delivery "upon firm sales contracts at fixed prices entered into before the date of the inventory" which it is required to inventory at cost. Article 1581, however, recognizes the right of a mining company, which keeps its accounts upon an accrual basis, to include its metals sold, but not shipped, in its accounts receivable rather than in its inventory if it elects so to do. This provision, however, can have no application to goods on hand at the date of the inventory which have not been sold.

It is recognized that, as contended by the taxpayer, to require an inventory at the close of 1917 to be made upon the basis of cost, or cost or market, whichever is lower, while leaving the inventory at the beginning of the year as it was originally made—that is, upon the basis of the selling price of all metals on

hand, sold, or unsold—would lead to a distorted statement of income. The inventory at the beginning of the year, which was the same as the closing inventory of the year 1916, must, therefore, be reconstructed, and amended returns made for the year 1916. If the adjustment due to the amended returns occasions an inequality in the tax prior to the year 1916, such inequality may be remedied in the return for 1916 by the deduction from or addition to the tax accruing in that year of an amount equal to the net amount overpaid or underpaid in prior years, such amount to be determined by filing with the return for 1916 a composite return for all prior years, accompanied by a statement showing the total adjustment for each of the years and the net income for the entire period.

It is accordingly held that a mining corporation, in computing its invested capital for the purpose of the war excess profits tax, is required to reduce its earned surplus by the amount of its sustained depletion to the beginning of the year for which the tax is computed, and, under normal conditions, to inventory its metals on hand at the close of its annual accounting period and not sold, at cost or cost or market, whichever is lower.

The Committee concurs in this conclusion of the Solicitor, and recommends its adoption

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I. ('22)-16-232: I. T. 1286

#### Revenue Act of 1918.

On January 1, 1918, the M Company had capital stock amounting to 2x dollars and surplus amounting to 11x dollars, most of which was earned surplus. During 1918 the company suffered an operating loss of 4x dollars.

Inquiry is made whether the invested capital of the company as at January 1, 1919, should be reduced because of the operating loss. It is contended that section 326(a)3 of the Revenue Act of 1918 makes no distinction between "paid-in surplus" and "earned surplus" and that surplus having once been earned and invested in the business is just as much a part of the capital investment as paid-in surplus or cash paid in for stock, and that consequently in computing invested capital no reduction of earned surplus is required because of an operating deficit.

Section 326(a) of the Revenue Act of 1918 provides, in part, that " \* \* \* as used in this title, the term 'invested capital' for any year means \* \* \* (3) paid-in or earned surplus and undivided profits; not including surplus and undivided profits earned during the year; \* \* \*." Under this provision of the statute, only true earned surplus and undivided profits can be included in the computation of invested capital. (See Regulations 45, article 838.) There is nothing in the statute defining the term earned surplus and undivided profits or modifying what must otherwise be accepted as the guiding principle to be applied in determining what is surplus. Under the statute, therefore, surplus in any case must be determined in accordance with the accepted principles of accounting. It is an accepted accounting principle that the surplus of a corporation is the excess of the net assets over the total par or face value of the shares of capital stock. The excess of the assets over the liabilities constitutes the net assets of a corporation. It follows that if an operating loss occurs during the year, other things being equal, the surplus at the end of the year is less than at the beginning of the year. The M corporation had on January 1, 1918, an earned surplus of approximately 11x dollars. During that year the operating expenses exceeded the income from operations by approximately 4x dollars. If such excess expenses



were paid with assets, the assets were actually reduced by such payments, resulting in a corresponding decrease in the net assets and in the surplus. If such excess expenses were not paid but were set up on the books as liabilities the resulting increase in the liabilities would also reduce the net assets and consequently the surplus by a corresponding amount. It is clear, therefore, that the surplus and undivided profits of the corporation on January 1, 1919, were approximately 4x dollars less than on January 1, 1918, by reason of the operating deficit occurring in 1918.

It is held, therefore, that the portion of the surplus of the corporation on January 1, 1918, representing earned surplus must be reduced by the operating deficit in computing the invested capital of the corporation as at January 1, 1919, but that portion representing paid-in surplus need not be reduced on account of the operating deficit for 1918 unless dividends were paid during the existence of the operating deficit in excess of the earnings available for distribution at the time the dividends were paid, as determined in accordance with articles 857 and 858 of Regulations 45.

8 not necessary to hold that the corporation had no surplus at the time of the operating deficit for 1918.

I (22)-25-357: A. R. R. 963.

**Act February 24, 1919, Sections 214(a)8 and 234(a)7. Act November 23, 1921, Sections 214(a)8 and 234(a)7.**

Recommended, upon the reconsideration of A. R. R. 27 (C. B. 2, p. 139) that obsolescence upon bulk freight vessels upon the Great Lakes be accepted as established by the evidence now on file; that such obsolescence be computed in the case of the various types and sizes of such vessels in accordance with the following recommendation; that Solicitor's Opinion 114 (C. B. 5, p. 148) be adhered to; and that the owners of such bulk freight vessels be not required to readjust their invested capital to allow for the obsolescence accrued up to and including December 31, 1917.

In December, 1919, a hearing was held by this Committee at which the representatives of the various steamship companies engaged in bulk transportation of ore, coal, stone, and grain upon the Great Lakes presented affidavits, and oral testimony was taken relating to the depreciation and obsolescence of bulk freighters on the Great Lakes. As a result of that hearing the Committee held (A. R. R. 27) that the maximum life of such vessels without rebuilding was 33 years and that, therefore, a deduction of 3 per cent on account of depreciation should be allowed thereon.

The recommendation added:

The committee is therefore of the opinion that obsolescence should be limited to those cases where it can be shown that a type of vessel has been developed so much more economical than existing types that no other than the new type will be built in future, and that a sufficient number of the new type to meet traffic requirements will in all reasonable probability be built within a certain definite period, thereby forcing the older type out of useful existence.

Where in any case this condition can be shown to exist and where moreover it can be definitely determined that the established rate of depreciation will not be sufficient to return all of the capital invested as at the date of acquisition or March 1, 1913, whichever was later, by the time the vessel will be rendered useless, an addition to the regular rate to cover this obsolescence may probably be allowed, thus permitting the spread of the foreseen loss over the period from the present time until the loss occurs instead of requiring the entire amount of such loss to be deducted in the year in which the vessel is finally scrapped or salvaged. The amount of this allowance, however, must be determined upon the basis of the facts in each particular case; that is, the type of the vessel in question, the fitness for possible use in other lines of transportation, and the date when it can be definitely foreseen that she will be no longer commercially useful in this particular line of traffic.

In accordance with this recommendation the owners of the bulk freighters were called upon by the Unit to establish the facts indicated therein as essential to the allowance of a deduction for obsolescence. At the same time

these owners were advised, as a result of the opinion of the Solicitor of the Bureau rendered June 23, 1921 (Sol. Op. 114), that, if deductions for obsolescence were claimed for the year 1918 and subsequent years, they would be required to adjust their invested capital for the year 1917 by deducting therefrom the obsolescence which had accrued up to and including December 31, 1917. The owners took the position that no readjustment of invested capital for the years prior to 1918 was contemplated or required either by A. R. R. 27 or Sol. Op. 114 and petitioned the Committee for a reconsideration of A. R. R. 27 and a restatement of the rule as to treatment of obsolescence in more definite form.

In connection with their petition the representatives of the owners filed numerous affidavits. These affidavits were supplemented by an oral hearing held by the Committee in January, 1922.

At the oral hearing there were present individuals representing directly or indirectly 75 per cent of the bulk freight traffic on the Great Lakes.

The testimony of all the witnesses is in striking accord as to existence, date of commencement, date of termination, and method of computation of obsolescence for the various types of Great Lake freighters, and the evidence may be briefly summarized as follows:

Up to 1905 all bulk freighters on the Great Lakes were of the beam and stanchion type of construction and ranged in carrying capacity from 5,000 to 6,900 tons. About 1905 the arch type of construction was introduced and larger vessels, ranging from 7,000 to 10,000 tons carrying capacity, began to be constructed. Owing to the change of type, the depth of the channels and the size of the wharfing, loading, and unloading facilities, doubts for some time were entertained as to the practicability of the larger boats and they did not demonstrate their practicability and dominate the lake traffic until the year 1910. Since 1910, vessels ranging from 11,000 to 13,000 tons capacity have been built, the average date of construction being 1914, and there are now 57 of these largest size vessels in service. No vessels larger than these have yet made their appearance. There is no obsolescence of any of these vessels for the first five years from the average date of construction, obsolescence for the next five years is slight, and from the tenth year on the obsolescence becomes more rapid and is progressive throughout the remainder of the useful life of the vessel, but any attempt to compute the actual rate of progression would be too complicated for practical use, and, therefore, obsolescence should be computed at a uniform rate over the entire period of its existence, or for such portion thereof as the law allows. The average term of usefulness of all of these vessels is approximately 20 years and at the end of 20 years they have a remaining value of 20 per cent of their original cost. If they are retained in service beyond the twentieth year, they lose value at the rate of one-thirteenth of the remaining value of the 20 per cent. If they become obsolete and are junked in less than 20 years, 4 per cent of the cost should be added to the value at the end of 20 years for each year less than 20 years.

The following composite table compiled from figures furnished by certain of the companies shows the average gross freights per mile, expenses, and net earnings for the various classes of vessels:



		Gross freights per mile.	Expenses.	Net earnings.
		Cents.	Cents.	Cents.
Over 10,000 tonners.....	1001	18.9x	11.2x	7.7x
10,000 tonners.....	800	14.9x	9.7x	5.2x
9,000 to 9,500 tonners.....	800	14.4x	9.7x	4.7x
8,000 to 8,500 tonners.....	800	11.8x	8.8x	3.0x
7,000 to 7,500 tonners.....	800	11.2x	8.5x	2.7x
6,000 to 6,500 tonners.....	800	11.9x	9.9x	2.0x
5,000 to 5,500 tonners.....	401	10.0x	9.0x	x

A table showing the corresponding figures for the intermediate tonnages was found to be too complicated and to show no material variations.

A statement furnished by A, auditor for the M Company, showed somewhat higher figures in all instances, but the increases were shown to be due to the fact that the M Company does not carry total loss insurance, which is generally carried on these vessels, resulting in a saving of about  $x$  cents a mile, and to more efficient operation. With the necessary allowance for these factors, the figures corresponded very closely to those shown by the composite figures of the companies named and the proportions as between the various classes of vessels were closely preserved.

An examination of this table shows clearly that so soon as enough vessels of a larger class, say of the 10,000 tonners, capable of earning  $5.2x$  cents net gross freight per mile, to meet the requirements of the traffic, have been constructed, the 5,000 tonners having a net earning capacity of only  $x$  cents will become economically impossible and will be driven out of business, and that if this occurs prior to the expiration of the period of 33 years, which has been accepted as the physical life of this class of vessels, there will be an amount, in excess of the junk value plus the depreciation which has been taken, for which no deduction will have been allowed. To illustrate: A 10,000-ton vessel built in December, 1910, will become obsolete on January 1, 1935. She will then be 24 years old, and, if the original owner continued in such ownership, he will have deducted 72 per cent for physical depreciation. By the time this 10,000-ton vessel is 24 years old she has a residual value of 14 per cent of the cost (computed on the basis of 20 per cent residual value when 20 years old). Adding together the 72 per cent for depreciation and the 14 per cent of residual value, we have 86 per cent of her cost accounted for and there remains 14 per cent to be deducted for obsolescence, to be spread evenly over the years 1917 to 1934, inclusive, or over such portion thereof as the law may provide. Again, a 5,000-ton vessel built in December, 1900, will become obsolete on January 1, 1922. She will then be 21 years old, and, if the original owner remains in such ownership, he will have deducted 63 per cent for physical depreciation. By the time this vessel is 21 years of age she has a residual value of about 18 per cent of cost (computed on the basis of 20 per cent residual value when 20 years old). Adding together the 63 per cent for depreciation and the 18 per cent of residual value, we have 81 per cent of her cost accounted for and there remains 19 per cent to be deducted for obsolescence, to be spread over the years 1910 to 1921, inclusive, or such portion thereof as the law may provide.

The evidence as to the average dates of construction and the dates of commencement and dates of determination of obsolescence for the various classes of vessels may be summarized as follows:

Tons.	Average date of construction.	Date obsolescence attaches.	Date when vessels will be obsolete.
5,000 to 5,900.....	1901	Jan. 1, 1910	Jan. 1, 1922
6,000 to 6,900.....	1903	Jan. 1, 1910	Jan. 1, 1923
7,000 to 7,900.....	1908	Jan. 1, 1915	Jan. 1, 1925
8,000 to 8,900.....	1908	Jan. 1, 1915	Jan. 1, 1927
9,000 to 9,900.....	1909	Jan. 1, 1917	Jan. 1, 1930
10,000.....	1909	Jan. 1, 1917	Jan. 1, 1935
Over 10,000.....	1914	.....	.....

The uniformity of the testimony upon the above points and the character and qualifications of the witnesses lead the Committee inevitably to the conclusion that these figures may be accepted for the purpose of computing obsolescence upon the various classes of vessels. The Committee is also convinced by the evidence that it is impracticable and unnecessary to compute the dates for smaller classes or for individual vessels.

In Sol. Op. 114, rendered at the request of the Income Tax Unit following A. R. R. 27, the Solicitor of the Bureau of Internal Revenue held that obsolescence should be spread over the entire period from date of commencement to the date it matured into obsolescence and that only that portion of obsolescence which accrued subsequent to January 1, 1918, could be taken in the returns for 1918 and subsequent years, any obsolescence not thus deductible being deducted as a loss in the year in which the vessel was junked.

The correctness of this ruling is attacked in the motion for reconsideration, it being contended that it was the purpose and intent of the provisions of section 214(a)8 and section 234(a)7 of the Act of February 24, 1919, that all of the obsolescence should be deducted in the period subsequent to January 1, 1918.

The Committee has carefully considered the ruling laid down in Sol. Op. 114 and has reached the conclusion that the rule there stated is the only one possible under the law. The Act of August 5, 1909, section 38 (second), provided for the deduction, in ascertaining net income, of "all losses actually sustained within the year and not compensated by insurance or otherwise, *including a reasonable allowance for depreciation of property, if any, \* \* \*.*" The Act of October 3, 1913, provided (Section II, Subdivision B) among other deductions "a reasonable allowance for *exhaustion, wear and tear of property* arising out of its use or employment in the business," and Subdivision G (b) provided, in the case of corporations, for the deduction of "all losses sustained within the year and not compensated \* \* \* *including a reasonable allowance for depreciation by use, wear and tear of property, if any.*" The Act of September 8, 1916, allowed, in the case of individuals, among other deductions (sec. 5, seventh) a reasonable allowance for *exhaustion, wear and tear of property* arising out of its use or employment in a business or trade and, in the case of corporations (sec. 12(a) second), "all losses actually sustained and charged off within the year \* \* \* *including a reasonable allowance for exhaustion, wear and tear of the property* arising out of its use or employment in the business or trade."

Under these several Acts the Bureau had uniformly held that the deductions for "depreciation," "exhaustion, wear and tear" were annual deductions to be made in the computation of annual net income and that the



depreciation, or exhaustion, wear and tear, which was not charged off in one year could not be accumulated and taken as a deduction in a following year. With knowledge, it must be assumed, of the established practice of the Bureau in this matter the Congress included in the deductions which might be here taken for depreciation or exhaustion, wear and tear "a reasonable allowance for obsolescence" (secs. 214(a)8, and 234(a)7, Act of February 24, 1919). The language employed is significant, "a reasonable allowance for exhaustion, wear and tear of property used in the trade or business, including a reasonable allowance for obsolescence." This language signifies that it was not the intent to add a new kind of deduction but to permit the inclusion of a different element, to wit, "obsolescence," in exhaustion, wear and tear. No different method of computing the deduction for obsolescence than that theretofore used in the case of exhaustion, wear and tear was prescribed, and the presumption from the language employed in permitting this deduction clearly indicates that a different method was not contemplated.

The existence of obsolescence under the earlier Acts was recognized but, as it was held not to be included in the terms "depreciation" or "exhaustion, wear and tear," a deduction on account of obsolescence was only permitted when it had ripened into obsolescence. Article 178 of Regulations 33, revised, thus provides:

Amounts representing losses on account of obsolescence of physical property may be included as a deduction from gross income as a loss, provided such amounts have been recorded in the books following the condemnation and withdrawal from use of the obsolete property.

As this resulted in throwing the total deduction for obsolescence as distinguished from depreciation into one year it frequently happened that the then income was less than the allowable deduction and the cost on March 1, 1913, value was not fully returned to the taxpayer. To relieve in a measure this situation Congress provided for the recognition of obsolescence as a progressive process as distinguished from obsolescence which was accomplished status, but, as clearly pointed out in Sol. Op. 114, there is nothing in the Act to indicate that Congress intended that this provision should have a retroactive effect. The language of sections 214(a)8 and 234(a)7 of the Act of November 23, 1921, which, so far as here pertinent, does not vary from the language of the corresponding sections of the Act of February 24, 1919, confirms the Bureau in the correctness of the conclusion heretofore reached upon this point.

The Committee has carefully considered the contention made on behalf of the owners of these lake freighters that the right to deduct accumulated obsolescence in succeeding years was recognized in T. B. R. 44 (C. B. 1, p. 133) in the case of good will, trade-marks, and trade brands. The language of the concluding paragraph of that recommendation must be admitted to lend some support to the contention, but a careful examination of the whole recommendation clearly shows that such was not the intent. On page 136 it is stated:

The trend of sentiment was early shown by the action of several States upon which the distillers and dealers in liquors were counting for success, and which were classed as doubtful by the prohibition forces. Thus in January, 1918, Massachusetts, Maryland, and Kentucky, the first two of which were considered very doubtful by the prohibitionists, voted in favor of the prohibition amendment by a decisive vote. Louisiana, another doubtful State, deadlocked in January upon the amendment, and later in the year ratified. It seems certain that an unprejudiced observer would, in view of the history of the movement and the decisive action taken by these doubtful States in January, have concluded that prohibition was a certain event, which, under the terms of the amendment, would become effective within a year from its final adoption. The conclusion is, therefore, reached that it is reasonable to allow distillers and dealers in liquors to make a deduction in computing

net income under the provisions of the Revenue Act of 1918 for any taxable year *ending on or after January 31, 1918*, and that the end of the period be fixed at the date upon which a taxpayer engaged as distiller or dealer in liquors discontinues such business, such date being in no case later than January 16, 1920, the date upon which prohibition by constitutional amendment becomes effective.

It is clear from this language that the Advisory Tax Board did not recognize obsolescence within the meaning of the statute as beginning prior to 1918, when the adoption of the constitutional amendment became a certainty. T. B. R. 44, therefore, is no authority for permitting the deduction of obsolescence which had accrued prior to 1918, in that and subsequent years, but must be considered only as dealing with the method of spreading the deduction over the period of obsolescence. In the method adopted it is the opinion of the Committee that it must be held to have been based wholly upon its peculiar facts and that the rule there laid down is not to be followed in other than identical cases.

The contention on behalf of the owners of lake freighters based upon the regulations governing deduction for amortization permitted by sections 214(a)9 and 234(a)8 of the Act of February 24, 1919, is without merit since the deduction expressly allowed by the statute is "of such part of the cost of such facilities or vessels as has been borne by the taxpayer," showing that a deduction of the entire amount was contemplated by the Congress.

The conclusion, however, which was drawn by the Unit from Sol. Op. 114, that, if the deduction for obsolescence were taken for the year 1918 and the following years, the invested capital for the preceding year must be readjusted to allow for the accrued obsolescence up to 1918, finds no support in that opinion or in A. R. R. 27, nor is it believed to be correct.

In article 42 of Regulations 41 it was provided:

In the computation of surplus and undivided profits, however, full recognition must first be given to expenses incurred and losses sustained from the original organization of the business concern down to the taxable year, including among such expenses and losses a reasonable allowance for depletion, depreciation, or obsolescence of property. \* \* \*

But it is clear that the word obsolescence here was incorrectly used. Deductions for obsolescence were not permitted in terms by the Act of October 3, 1917, and in article 178 of Regulations 33, revised, construing the term "obsolescence" for the purpose of the income tax, it was prescribed:

Amounts representing losses on account of obsolescence of physical property may be included as a deduction from gross income as a loss, provided such amounts have been recorded in the books following the condemnation and withdrawal from use of the obsolete property.

Showing clearly that the word "obsolescence" was there construed as meaning obsolescence, and there is no authority for adopting a different meaning for the purpose of computing invested capital under the War Excess Profits Tax title of the Act.

Article 838, Regulations 45 (1920 edition), provides:

In the computation of earned surplus and undivided profits full recognition must first be given to all expenses incurred and losses sustained from the original organization of the corporation down to the taxable year, including among such expenses and losses reasonable allowances for depreciation, obsolescence, or depletion of property (irrespective of the manner in which such property was originally acquired). \* \* \*

But this is no authority for requiring a deduction of accrued obsolescence prior to the year 1918. The article in question construes the Act of 1918, which expressly permitted deductions for obsolescence. And, too, the allowance provided by the statute on account of obsolescence is a "reasonable allowance." In A. R. M. 106 (C. B. 4, p. 390) the Committee expressly recognized that it would be unreasonable to require the reduction of earned surplus unless the depreciable assets of the corporation were valued on its



books at the beginning of the taxable year at an amount in excess of their actual value at that time and quoted with approval the following from article 839 of Regulations 45 (1920 edition):

Adjustments in respect of depreciation or depletion in prior years will be *made* or permitted only upon the basis of affirmative evidence that as at the beginning of the taxable year the amount of depreciation or depletion written off in prior years was insufficient or excessive, as the case may be.]

And in an informal memorandum the Committee has expressed an opinion that:

No reduction in earned surplus should be made in any case where, because of repairs, renewals and replacements, the property as a whole remains unimpaired either in intrinsic value or efficiency.

The principle last stated is peculiarly applicable to obsolescence. Obsolescence, of which the case here presented is typical, is not like depreciation, a matter of decrease in earning power or in absolute efficiency, but only in relative efficiency. It has its origin in the fact that although the original efficiency be maintained, yet, owing to improvements in the art or changed economic conditions, a device or factor in production will eventually have to be discarded. The loss is a future loss, but for equitable reasons the statute permits it to be spread over the period for which it can be foreseen, and allows the portion assignable to the period subsequent to December 31, 1917, to be deducted pro rata over such period.

In the instant case the vessels of the 5,000-ton class will to-day net  $x$  cents freight per mile, as when they were first constructed. Their intrinsic value is unimpaired, but, because the newer and larger type will earn from six to eight times as much, it is evident that, when the number of larger vessels becomes sufficient to handle the carrying trade of the Great Lakes, the smaller vessels will become economically impossible of operation and will necessarily be discarded or junked. Under the principle laid down in A. R. M. 106, as subsequently explained, therefore, there is neither justification nor reason in requiring the reduction of the invested capital in the case of these bulk freighters prior to the time such deductions were actually taken in the computation of net income.

It is, therefore, recommended, upon reconsideration of A. R. R. 27, that obsolescence upon bulk-freight vessels upon the Great Lakes be accepted as established by the evidence now on file; that such obsolescence be computed in the case of the various types and sizes of such vessels in accordance with the above recommendation; that Solicitor's Opinion 114 be adhered to; and that the owners of such bulk-freight vessels be not required to readjust their invested capital to allow for the obsolescence accrued up to and including December 31, 1917.

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I ('22)—36-494: I. T. 1440

### Revenue Acts of 1917, 1918, and 1921.

Depreciation of fixed assets continues whether a taxpayer earns an income or suffers a loss, and its earned surplus should be reduced on account of depreciation, although it sustained a loss for the taxable year. In determining invested capital for subsequent years, the paid-in capital and surplus of the taxpayer are not affected by such depreciation, but if this depreciation has more than exhausted earned surplus, the deficit thus caused must be made good out of the earnings of the company before any earned surplus can be included in invested capital.

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**Law Section 326.—Invested Capital (1918 Act—¶555, ante): (1921 Act—¶1035, post).**

**Article 839.—Surplus and undivided profits: allowance for depletion and depreciation (Reg. 45—¶762, ante): (Reg. 62—¶1195, post).**

9-21-1489: O. D. 833.

Amounts charged off for depletion of stumpage during the years 1909 to 1913, and disallowed as a deduction from gross income can not, merely because of the disallowance, be restored to invested capital. Adjustments in respect to depletion will be made only in accordance with Article 839 of Regulations 45.

1

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18-21-1614: A. R. M. 106.

[For this Committee on Appeals and Review Memorandum No. 106 see Service ¶877.]

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30-21-1748: A. R. M. 106 Explained.

[For this explanation of Committee on Appeals and Review Memorandum No. 106, see Service ¶879.]

3

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46-21-1927: O. D. 1104.

[For this O. D., further relating to A. R. M. 106, above, see Service ¶885.]

4





Law Section 326.—Invested Capital (1918 Act-¶555, ante): (1921 Act-¶1035, post).

Article 840.—Surplus and Undivided Profits: Additions to Surplus Account (Reg. 45-¶764, ante): (Reg. 62-¶1196 post).

2-19-151: T. B. R. 6.

(1) Where a distilling corporation pursuant to a resolution of the board of directors charged against surplus in 1912 and 1913 amounts aggregating \_\_\_\_\_ dollars on the ground of alleged obsolescence of a part of its equipment and the entire equipment was continued in use the same as previously, no reduction of output being made and no portion of the property having been retired or scrapped, in fact, no change being made beyond the arbitrary reduction of the surplus and invested capital by charging off the \_\_\_\_\_ dollars on the books of the corporation, it having been shown that these charges were made only for the consideration of the corporation and that they did not enter into the corporation's income tax returns, the amounts so charged off may be restored to invested capital, less proper allowance for ordinary depreciation.

1

15-19-452: T. B. M. 56.

Amortization allowances deducted in ascertaining net profits for the purpose of the munition manufacturer's tax act (Title III of the Revenue Act of 1916) do not affect "invested capital" under the Revenue Act of 1918.

The munition manufacturer's tax was laid "upon the entire *net profits* actually received or accrued" from the sale or disposition of specific munitions, and it was provided in section 202:

That in computing net profits under the provisions of this title for the purpose of the tax there shall be allowed as deductions from the gross amount received or accrued for the taxable year from the sale or disposition of such articles manufactured within the United States, the following items: \* \* \* (f) A reasonable allowance according to the conditions peculiar to each concern, for amortization of the values of buildings and machinery, account being taken of the exceptional depreciation of special plants.

It is apparent from this language that the amortization allowance in question was authorized for the purpose of computing "net profits," not "net income." The right to make a deduction for amortization in computing net income for the income tax did not exist and was repeatedly denied by the bureau prior to the passage of the Revenue Act of 1918. It is to be noted further that the taxes imposed by Title II of the Revenue Act of 1917 and Title III of the Revenue Act of 1918 were explicitly laid upon "net income," and were in a variety of ways impressed with the stamp and character of an income rather than a munition manufacturer's tax. They are in no sense mere continuations or expansions of the tax imposed by Title III of the Revenue Act of 1916. It follows, therefore, that the deduction for amortization under the munition manufacturer's tax law was not allowed for income tax purposes and should not now be permitted to affect the surplus or any other element entering into the "invested capital" employed for purposes of the war profits and excess profits taxes.

This conclusion is supported by the character of the amortization allowance in question. It was in many respects quite dissimilar from the depreciation and depletion allowances. It was not based upon the fact that plant and equipment acquired in the year 1916 or earlier for the manufacture of munitions, actually depreciated in use or market value during the taxable year 1916. There was in general no such depreciation in value or impair-

ment of useful life. Account was taken "of the exceptional depreciation of special plants" but the principal allowance was "for the amortization of the values of buildings and machinery," whether those values increased or decreased in the immediate future. The principal amortization allowance looked to the establishment of a special fund to recoup exceptional war costs when war uses had ceased; it did not imply that there had been or would be any immediate impairment of physical assets, such as is covered by the depletion allowance, or any immediate exhaustion, wear, tear, or obsolescence in excess of the amount covered by the depreciation allowance. It was, as stated, a special allowance peculiar to this tax, designed possibly to moderate the (then) exceptionally high rates of the munition manufacturer's tax.

Reference has been made in this connection to the wording of section 214 (a) (9) and section 234 (a) (8) authorizing a deduction for amortization under the Revenue Act of 1918; but upon careful examination these paragraphs are found to have no bearing upon the present case.

It is the opinion of the Advisory Tax Board, therefore, that deductions for amortization taken under the munition manufacturer's tax act do not affect the computation of the invested capital under the Revenue Act of 1918 of the corporations which took such deductions.

2

19-20-926: A. R. R. 100.

#### REVENUE ACTS OF 1916 AND 1917.

In re: Additional income and excess profits taxes for 1917 and 1918 and munition taxes for 1916 and 1917 assessed against the M Company.

The Committee has had under consideration the informal appeal of the M Company against the assessment of additional income and excess profits taxes for 1917 and 1918 and of munition taxes for 1916 and 1917.

Four questions were raised by the taxpayer: (1) Liability to munition taxes; (2) value of assets turned over to the corporation on organization; (3) a deduction taken in 1918, covering so-called copper replacement liability; and (4) losses upon the sale of the property. The Unit concedes the correctness of the deduction for loss on the sale of the property, and upon the argument of the case before the Committee the appeal relative to the copper replacement liability was abandoned by the attorney for the company, leaving only two questions to be decided.

\* \* \* \* \*

The second question relates to invested capital. It appears that A, in the early part of 1916, purchased the plant and sundry assets for 11x dollars, and that in September, 1916, after rearranging and modifying the machinery and equipment and securing contracts for the manufacture of shell rings, sold the property to the M Company, receiving payment therefor in stock, the revenue agent stating that 2,750 shares of the total issue of 3,000 were turned over to A for this property. It is presumed that the other 250 shares were issued for cash, and upon the theory that the assets turned in for stock under such conditions had an actual cash value equal to the par of the stock issued therefor, the value of tangibles and intangibles acquired from A would be 14x dollars. Claim is made that the value of the intangibles was increased by A after the purchase by himself by reason of his personal services as an engineer in developing the property and perfecting certain processes for which he did not credit himself when constructing the plant and organizing the business.



The Unit concedes that so much of the increased value as represents actual additions and betterments to the plant may be regarded as invested capital and in this view the Committee concurs. However, in the absence of proof as to additions and betterments made, the Committee is of the opinion that the difference between the purchase price of 11x dollars in the early part of 1916 and the selling price in September, 1916, constitutes an intangible asset or good will subject to the 20 per cent. limitation under the 1917 Act.

The Committee therefore recommends that the action of the Unit with respect to invested capital be sustained.

3

50-20-1347: A. R. R. 337

Held, that appreciation of good will and tangible property determined by appraisal against which a stock dividend was issued can not be allowed under article 42 of Regulations 41 and 840 of Regulations 45 as invested capital for excess profits tax purposes.

The M Company was incorporated in 188-. In 189- the corporation purchased from the N Company, a separate corporation, its assets valued at 150x dollars, including good will of 65x dollars for which there was issued 150x dollars in common stock. The item of good will was subsequently written down to x dollars.

In 1912 the corporation had an appraisal made and increased its surplus through this appraisal by setting up good will at 500x dollars and tangible assets at 150x dollars. Against this increase in surplus there was issued, by way of stock dividend, 400x dollars in preferred stock and 250x dollars in common stock. The revenue agent, who made an examination of the taxpayer's books, disallowed all of the appreciation for good will except 65x dollars, which had been acquired by the issuance of stock in the purchase of the assets of the N Company in 189-, and all of the appreciation in tangible property which was not clearly shown to have been paid in and thereby properly credited to surplus.

The taxpayer, in filing his returns for 1917 and 1918, claimed the total appreciation both for good will and tangible property, applying, however, the statutory limitation of 20 per cent for good will in 1917 and 25 per cent in 1918.

Under assessment by the Income Tax Unit, which sustained the findings of the revenue agent, the taxpayer submitted evidence in the form of an affidavit signed by the president of the company, showing that good will aggregating in value 95x dollars had been actually acquired for cash in addition to the 65x dollars good will acquired for stock as above stated. The Income Tax Unit thereupon revised its assessment and allowed the taxpayer for invested capital purposes a total good-will valuation of 160x dollars. The taxpayer has appealed from this revised assessment and now claims the full appreciation made in 1912 for both tangible and intangible properties, subject only to the statutory limitations of 20 per cent and 25 per cent for the years 1917 and 1918, respectively.

Article 42 of Regulations 41 provides that—

If value appreciation of a kind not subject to income tax (other than that allowed under article 55) has been taken up in the accounts a deduction must be made in respect of such appreciation so taken up.

Article 55 provides that—

Tangible property paid in for stock or shares prior to January 1, 1914, must be valued at either (a) the actual cash value of such property on January 1, 1914, or (b) the par value of the stock or shares specifically issued therefor, whichever is lower. This is one of the few cases in which the law permits allowance to be made for appreciation, and here no appreciation can be recognized unless the original stock or shares were *specifically* issued in exchange for such tangible property.

It must be observed, first, that the appreciation of taxpayer's assets as of January 31, 1912, was not subject to income tax, and, second, that only tangible property may be appreciated to (a) the actual cash value of such property on January 1, 1914, or to (b) the par value of the stock *specifically* issued therefor, whichever is lower. It can not be claimed that a stock dividend issued against a surplus reflecting an appraisal of both tangible and intangible property is an original issue of stock specifically exchanged for tangible property.

Article 64 (2) provides that—

Amounts expended in the past for good will, trade-marks, trade brands, franchises, and other intangible assets of a like character, are controlled by the language of the statute which provides that such assets "shall be included in invested capital if the corporation or partnership made payment bona fide therefor specifically as such in cash or tangible property." The Commissioner of Internal Revenue will recognize additions to invested capital on account of intangible assets only if such assets have been explicitly paid for in the manner prescribed by the statute. Where expenditures have been made for the general development of intangible assets and charged as current expense, no readjustment thereof will be allowed.

From the facts as stated, the Income Tax Unit, in its revised assessment letter, allowed an aggregate for good will of 160x dollars. With the exception of 65x dollars of this amount, the good will so allowed was acquired for cash prior to March 1, 1913, according to affidavit of the president of the company. These items were properly restored to invested capital under article 64(2) and (3). The item 65x dollars for good will on the books of the N Company was acquired for stock. The value of this item at date of acquisition is a matter of proof. Under article 57 of Regulations 41 evidence sufficient to determine proper allowance as invested capital has not been submitted to the Committee.

The Committee therefore sustains the action of the Income Tax Unit in disallowing, under article 42 of Regulations 41 and under article 840 of Regulations 45, appreciation of either good will or tangible property. The Committee further sustains the Unit in allowing, under article 64(2) and (3) of Regulations 41 and article 842 of Regulations 45, the good will acquired for cash prior to March 1, 1913. Allowance for invested capital of tangible or intangible property acquired for stock is subject to the limitations prescribed by articles 55 and 57 of Regulations 41.

4

52-20-1367: A. R. R. 349

The opinion of the Committee is requested whether the M Company should receive the benefit of an addition to invested capital, for excess profits tax purposes, by submitting amended returns for the years 1916 and 1917; in which returns a deduction for amortization, claimed and allowed in the original returns, should be eliminated.

The facts as stated are that the above-mentioned company manufactured munitions. In its income tax returns for the years 1916 and 1917, the company has claimed amortization of the facilities for their



manufacture in the same amount as appeared upon their munition manufacturer's returns and the taxpayer now seeks to eliminate from its income tax returns the amount of such amortization which, it is said, has been included therein.

This request on the part of the taxpayer has heretofore been denied by the Unit.

Title III of the Revenue Act of 1916, known as the "Munition Manufacturer's Tax," imposes a tax upon the entire net profits received or accrued from the sale or disposition of certain specified articles of munitions manufactured within the United States, and for the purpose of computing such net profits permits certain deductions, among which, under section 302 (f), is—

A reasonable allowance according to the conditions peculiar to each concern, for amortization of buildings and machinery, account being taken of the exceptional depreciation of special plants; and Regulations 39 promulgated under the provisions of the Act, provide more specifically, in article 21, what shall constitute such "amortization" and how the amount thereof shall be determined.

The Revenue Act of 1916, both as passed originally and as amended by the Revenue Act of 1917, not only does not provide specifically for any allowance for amortization for income tax purposes, but in Regulations 33, revised, promulgated thereunder, specifically prohibits such an allowance although recognizing an allowable deduction on account of *depreciation* in the value of any class of property subject to wear and tear.

Article 162 of Regulations 33, revised, provides that:

The deduction to be allowed relates solely to loss due to use, wear and tear, and the matter of obsolescence is not relevant inasmuch as when the property becomes obsolete a deduction for the loss sustained thereby, representing the difference between the cost and the amount of depreciation previously charged off or which should have been charged off in prior years, will be allowed.

It appears that in preparing its munitions tax returns and its income and excess profits tax returns, this taxpayer deducted in its income tax return the same amount which had been deducted in its munitions tax return; such amount including a charge for amortization (or obsolescence), as well as a charge for depreciation, and this charge, in the audit of the taxpayer's income tax return by the Unit, was allowed as a deduction although obviously the Unit was in error in making such an allowance.

It is, therefore, recommended that this taxpayer be permitted to file amended income tax returns for the years affected, from which returns shall be excluded as deductions the charges for amortization included within the returns as originally filed, and that the deductions thus excluded shall be allowed as additions to the invested capital of the taxpayer for profits tax purposes.

5

18-21-1615: O. D. 901

Where a corporation claims as an addition to its invested capital for 1917 and subsequent years the excess of the value of its patterns over the value at which they have been carried on its books, and such claim comes within the provisions of articles 840 (2) and 841 (1) of Regulations 45, amended returns may be filed for each year for which an erroneous return has been made both before and after March 1, 1913. Any overpayment of taxes for the years 1917 to 1920 shown on the basis of the amended returns may be made the subject of a claim for refund.

6

Recommended, that the action of the Income Tax Unit in disallowing the M Company its claim for capitalization of amounts expended prior to January 1, 1909, for the purpose of increasing the circulation of its paper be sustained under articles 840 and 841 of Regulations 45.

The Committee has had under consideration the appeal of the M Company from the action of the Income Tax Unit in denying the right to capitalize amounts expended prior to January 1, 1909, which the corporation claims were for the purpose of increasing the circulation of the newspaper published by it.

The M Company was incorporated in 188— with a capital stock of  $x$  dollars, and has been since its inception a close corporation. It is claimed that the profits of the company have been used to build up its business and that no additional capital has ever been paid in. It is further stated that due to the fact that the corporation stock has always been closely held no distinct effort has been made to separate capital expenditures from current expenses in years gone by. The company proposed to include in invested capital an item of  $20x$  dollars as an intangible asset representing the cost of acquiring its circulation list. This amount is determined by an analysis of the records of expenditures of the company from the beginning of its business to December 31, 1908. It is stated this analysis separates all expenditures which have been made for maintenance of old circulation and for the acquirement of additional circulation and all expenditures which can be properly classed as chargeable to advertising.

In the cost of circulation the appellant has included cost of gathering and disseminating news, cost of editorials, and other features and general expenses. Expenses have been apportioned between "advertising" and "cost of circulation" on the basis of the column devoted to each in the daily issues. In setting up the capital expenditures of each year to cover the "cost of increased circulation" the appellant has used as a basis that portion of the entire circulation cost of each year as is represented by the average daily increase over the previous year divided by the average daily circulation of the current year. On this basis of apportionment exhibits have been submitted for each year from 188— to 1908, inclusive, and on basis of these exhibits its original claim for invested capital amounting to  $20x$  dollars has been amended to  $10x$  dollars.

The company claims to have made a consistent effort to increase the circulation of its publication, through the inclusion in its columns of certain special features which, in themselves while nonrevenue producing, appealed to the home. The company claims never to have abnormally increased the cost of acquiring circulation by spectacular methods such as offering of premiums, prizes, bonuses, etc., and that as a result the newspaper has a stable home circulation and an advertising clientele consisting of not only local advertising but those located in a near-by city. It is noted the amount claimed as invested capital on account of its expenditures for circulation is limited to the period prior to the year 1909.

The Income Tax Unit does not question the value of the circulation in commanding high rates for advertising, nor does it question the propriety of capitalizing such amounts as can be determined to have been expended specifically for the increase in circulation, but contends that it is not practicable to ascribe the increase in circulation to any specific part of the paper or to any particular feature or features, notwithstanding the fact that the features appear to have been used with that sole end in view.



This Committee has, in several instances, stated that in its opinion expenditures made prior to 1909 in the development of an intangible asset and distinctly set aside at the time and capitalized by the issuance of stock gave a definite right to a claim for additional invested capital. In the instant case, however, the corporation exercised its option in charging to current expenses not only the cost of publication but whatever direct cost there may have been incident to building up a large circulation list.

Article 840 of Regulations 45 provides, in part, as follows:

(3) Amounts which have been expended in the past for intangible property of any kind can be restored to capital or surplus account only to the extent that the corporation specifically paid such amounts for the intangible property as such.

Article 841 makes further provision that:

Additions to surplus which a corporation may desire to make under the preceding article (840) fall broadly into two classes:

(1) To correct returns of net income for prior years in which actual errors have been made, as, for example, where excessive depreciation has been deducted, additions to plant and equipment or other capital charges have been charged off as an expense, inventories have been taken upon a wrong basis of valuation, etc.

(2) To reinstate in surplus deductions from income which are, as a matter of good accounting, to some extent optional, such as experimental expenses, patent litigation, development of good will through advertising or otherwise, etc.

Appellant's claim must of necessity rest on the conditions stated in paragraph 3 of article 840, but the article further provides that:

Adjustments falling in class (2) can not be permitted, as in such cases it is considered that the corporation has exercised a binding option in deducting such expenses from income. An election of this sort which was made concurrently with the transaction can not now be revised, and amended returns in respect thereof can not be accepted.

In the instant case the taxpayer has not shown the extent to which the corporation specifically paid amounts for intangible property as such or for the development of an intangible asset, nor has it shown that such expenditures, when made, were currently set aside and capitalized. The expenditures have been apportioned under the exhibit submitted between "advertising" and "cost of circulation" on the basis of the columns devoted to each in the daily issues, and the entire circulation cost of each year is represented by the average daily increase over the previous year divided by the average daily circulation of the current year. As above suggested, such a basis of claim for an intangible value does not meet the requirements of the regulations.

The Committee, accordingly, recommends that the action of the Income Tax Unit in disallowing the M Company its claim for capitalization of amounts expended prior to January 1, 1909, for the purpose of increasing the circulation of its paper, be sustained under articles 840 and 841 of Regulations 45.

7

47-21-1937: A. R. M. 141.

Held, in the matter of the contention of the M Company and the O Company, taxpayers engaged in the publication of newspapers, that moneys expended out of earned surplus or current earnings for the sole purpose of building up the circulation structure may be added to capital invested when proper proof of such expenditures is made and amended returns for prior years have been filed, and that the circulation structure so built up is intangible property as defined in the regulations.

The Committee has had under consideration the general question presented by the M Company and the O Company, taxpayers engaged in the publication of newspapers, as to whether items expended for circulation

building are part of invested capital; also whether the circulation structure should be considered as tangible or intangible property.

During the latter part of July a hearing was granted to the parties, at which time they were represented by attorneys.

It appears that many corporations engaged in the publication of newspapers have built their circulation structure through the expenditure of earnings. Some papers, however, acquired for a cash consideration this structure. It is contended that a newspaper concern can not make any money until the circulation structure is established. The extent to which it can sell advertising space and the price which it can get for that space are dependent on the size and character of that structure—that is, the form of circulation. There is no doubt that this structure is property which produces earnings on which the corporation pays tax, and there is no doubt that the amount of the earnings is measured to a great extent by the character of the circulation structure, and that the extent and character of the structure are dependent on the expenditures made to build or to purchase it.

It was pointed out that in the sale of newspaper property the principal thing considered by the purchaser is the circulation structure. In many cases the expenditures made for this structure have not been reflected in surplus, due to the concern's bookkeeping practice.

It has been the policy of the Bureau in instances where the expenditures made in building the circulation structure are not reflected in surplus on the books of account, to give special treatment and assess the taxes under the provisions of section 210 of the 1917 Act and sections 327 and 328 of the 1918 Act. It is now contended that this practice should be discontinued and that corporations publishing newspapers should be permitted to increase the surplus account by an amount sufficient to cover the expenditures for building the circulation structure, and that the regulations which classify the circulation structure as intangible property should be repealed.

In order to reach a correct conclusion in this matter it is necessary to examine the provisions of the statute defining tangible and intangible property; also the provisions defining invested capital.

Section 207 of the Revenue Act of 1917 provides that capital invested includes the following:

(a) In the case of a corporation or partnership: (1) Actual cash paid in, (2) the actual cash value of tangible property paid in other than cash for stock or shares in such corporation or partnership at the time of such payment (but in case such tangible property was paid in prior to January first, nineteen hundred and fourteen, the actual cash value of such property as of January first, nineteen hundred and fourteen, but in no case to exceed the par value of the original stock or shares specifically issued therefor), and (3) paid in or earned surplus and undivided profits used or employed in the business, exclusive of undivided profits earned during the taxable year: \* \* \*

(b) The good will, trade-marks, trade brands, the franchise of a corporation or partnership, or other intangible property, shall be included as invested capital if the corporation or partnership made payment bona fide therefor specifically as such in cash or tangible property, the value of such good will, trade-mark, trade brand, franchise, or intangible property, not to exceed the actual cash or actual cash value of the tangible property paid therefor at the time of such payment \* \* \*

Article 47, Regulations 41, defines tangible property and intangible property as follows:

The term "other intangible property" as used in section 207 will be construed to mean property of a character similar to good will, trade-marks, and the other specific kinds of property enumerated in the same clause. With respect to property not clearly of such a character, rulings will be issued as occasion may demand to indicate whether it shall be regarded as tangible or intangible.



Section 326(a) of the Revenue Act of 1918 provides that invested capital includes the following:

- (1) Actual cash bona fide paid in for stock or shares;
- (2) Actual cash value of tangible property, other than cash, bona fide paid in for stock or shares, at the time of such payment, but in no case to exceed the par value of the original stock or shares specifically issued therefor \* \* \*;
- (3) Paid in or earned surplus and undivided profits; not including surplus and undivided profits earned during the year.

Section 325(a) of the Revenue Act of 1918 provides, in part, as follows:

The term "intangible property" means patents, copyrights, secret processes and formulae, good will, trade-marks, trade brands, franchises, and other like property;  
The term "tangible property" means stocks, bonds, notes, and other evidences of indebtedness, bills and accounts receivable, leaseholds and other property other than intangible property.

Article 811 of Regulations 45 provides, in part, as follows:

\* \* \* Associated Press, United Press, and similar franchises, and subscription lists and mailing lists are intangible property.

Article 840, Regulations 45, provides in part as follows:

A corporation's books of account will be presumed to show the facts. If it claims that its capital or surplus account is understated the burden of proof will rest upon it. Additions to such accounts will be accepted to the following extent:

(3) Amounts which have been expended in the past for intangible property of any kind can be restored to capital or surplus account only to the extent that the corporation specifically paid such amounts for the intangible property as such. For provisions relating to patents see article 843.

(4) Adjustments necessary to correct other errors found in the books of account may be made. But see the following article.

Article 841, Regulations 45, reads in part as follows:

Additions to surplus which a corporation may desire to make under the preceding article fall broadly into two classes:

(1) To correct returns of net income for prior years in which actual errors have been made, as for example where excessive depreciation has been deducted, additions to plant and equipment or other capital charges have been charged off as an expense, inventories have been taken upon a wrong basis of valuation, etc.

(2) To reinstate in surplus deductions from income which are as a matter of good accounting to some extent optional, such as experimental expenses, patent litigation, development of good will through advertising or otherwise, etc.

Adjustments falling in class (1) will be permitted for all years whether before or after March 1, 1913, provided amended returns of net income are filed for each year in which an erroneous return has been made. \* \* \* Adjustments falling in class (2) can not be permitted, as in such cases it is considered that the corporation has exercised a binding option in deducting such expenses from income. An election of this sort which was made concurrently with the transaction can not now be revised, and amended returns in respect thereof can not be accepted.

From the foregoing it will be noted that earned surplus is a part of the invested capital. It does not matter whether this earned surplus is invested in plant and equipment or is retained in cash. The Bureau has consistently held that amounts which have been expended in the past for intangible property of any kind can be restored to surplus account to the extent that the corporation specifically paid such amounts in cash for the intangible property as such. Restoration to surplus account can be made only when the amounts expended can be identified. The corporation must, in order to restate the surplus account, show that the amounts expended were expended specifically for an asset whether tangible or intangible.

In a recent case decided by the Committee it was held that expenditures made for building up the circulation structure may be added to capital invested when proper proof is made. In that case the expenditures asserted were for inclusion in the columns of certain special features, the company

claiming not to have resorted to any "spectacular methods such as offering of premiums, prizes, bonuses, etc." The propriety of capitalizing such amounts as can be determined to have been expended for the increase in circulation can not be questioned, but in most cases which have come before the Committee it has not been practicable to ascribe the increase in circulation to any specific part of the expenditure. The difficulty in most cases seems to be that the taxpayer can not furnish satisfactory evidence to prove its case. Each case must be adjusted and settled upon its own merits and if a taxpayer can prove the case, then the matter of restating the surplus is a simple one. If the records of any taxpayer are so kept that proof of the amount invested in the circulation structure can be made in actual figures and can be identified as specifically paid in building up the circulation structure, the Committee can not see any reason for denying such taxpayer the right to restate the surplus.

Taxpayers of this class who have not kept sufficient records and who are unable to prove their cases are entitled to the benefit of section 210 of the Revenue Act of 1917 and sections 327 and 328 of the Revenue Act of 1918. The tax in these cases must be established on a comparative basis. The only proper comparatives would be such concerns as could show the cost of the circulation structure and in this way the entire capital invested may be recognized in computing the tax of a concern which can not properly prove its case.

The Committee does not think favorably of the suggestion made by the attorneys that affidavits should be secured from a large number of publishers showing the cost per subscriber of their circulation structure and the use of these affidavits in arriving at a cost per unit per subscriber for the purpose of invested capital. This basis is too speculative for use in the computation of invested capital.

After making an exhaustive study of the principle involved and the assessment of taxes against taxpayers engaged in the business of publishing newspapers, the Committee must decline to accept the view of the attorneys for the taxpayers with respect to the classification of circulation structure. The regulations properly classify such property as "intangible property." However, expenditures of an investment nature may be made a part of earned surplus upon submission of appropriate proof and the amounts so expended may be included in earned surplus whether expended for tangible or intangible property.

In view of the foregoing, the Committee is of the opinion in the matter of the argument of the M Company and the O Company, taxpayers engaged in the publication of newspapers, that moneys expended out of earned surplus or current earnings for the sole purpose of building up the circulation structure may be added to capital invested when proper proof of such expenditures is made and amended returns for prior years have been filed, and that the circulation structure so built up in intangible property as defined in the regulations.



I ('22)—15-219: I. T. 1278.

**Revenue Act of 1921.**

Inquiry is made as to whether the cost of rotogravure supplements comes within the purview of A. R. M. 141 [Ruling No. 8, above], which permits taxpayers engaged in the publication of newspapers to include in their invested capital, for tax purposes, moneys expended out of earned surplus or current earnings for the sole purpose of building up the circulation structure. It is stated that newspaper publishers employ rotogravure supplements largely as a circulation stimulant.

The question to be determined in cases affected by the ruling above referred to is whether the amounts claimed as an addition to invested capital can be identified as having been expended out of earned surplus or current earnings for the sole purpose of building up the circulation structure. It is believed that rotogravure supplements constitute a part of the news service furnished by newspapers to their subscribers and are not of such a nature that the expense thereof can be said to be incurred solely for the purpose of building up the circulation structure. It, therefore, follows that the moneys expended therefor may not be added to invested capital.

9

I ('22)-49-629: I. T. 1524.

**Revenue Act of 1921.**

A reserve for bad debts carried by a corporation on December 31, 1920, may be included in invested capital for 1921, subject to proper adjustment during the year to the extent thereafter utilized to liquidate debts outstanding on December 31, 1920, subsequently determined to be worthless. Any portion of such reserve which the taxpayer considers not necessary for bad debt purposes may be restored to surplus.

10





**Law Section 326.—Invested Capital (1918 Act—¶555, ante): (1921 Act—¶1035, post).**

**Article 841.—Surplus and Undivided Profits; Limitations of Additions to Surplus Account (Reg. 45—¶769, ante): (Reg. 62—¶1201, post).**

3-19-206: T. B. R. 19.

A corporation acquiring with stock the assets of a previously existing corporation, among which assets are included trade-marks, good will, etc., can not claim as an addition to invested capital amounts expended by the predecessor corporation for the general development of such intangibles and charged by it as current expense.

1

(See 8-19-319; Section 311, Article 781.) Adjustment of salaries paid during prewar period.

2

2-20-679: A. R. M. 12.

At the request of the Commissioner this Committee has given an oral hearing to representatives of the proprietary medicine manufacturers in general, and of the M Company in particular, upon the question of an addition to invested capital through the recognition of a portion of the amounts spent in prior years for advertising and developing trade-marks and trade brands.

It was stated at the hearing that the methods pursued by the company named above are essentially similar to those followed by many other manufacturers engaged in the same industry, and that this case is a typical one. The asset of greatest value of the M Company is a formula and trade-mark. When this asset was acquired, the product had a certain sale in limited territory. Profits from the sale of the product were reinvested in development of new territory. For instance, if the company decided that it would undertake to develop any territory where it had previously sold no goods, it would institute an intensive advertising campaign in that territory by newspaper and other advertising agencies, distribution of samples, etc. The next year some other territory would be chosen. During this period of development it is claimed that the amount expended in advertising in a given territory was far in excess of the profits made from sales in such territory, and it is, therefore, claimed that a portion of all such expenditures is in reality a capital investment and not merely expense of selling, since it is an investment from which returns are to be expected in the future rather than in the immediate present. It must be conceded that in theory some proportion of all advertising is in effect the building up of good will, but it is the judgment of the Committee that it is impossible to allocate any definite percentages as between capital investment and selling costs.

It seems clear to the Committee that no court would permit the disallowance of a proportion of reasonable advertising in a return of income on the ground that such advertising was a capital investment and not an actual necessary expense of business, and if that be true the converse must follow, namely: that the corporation can not claim that any proportion of such expense is capital investment and not business expense.

It was also brought out at the hearing that there have been a number of widely advertised trade-marks of this character sold within recent years and that such sales were usually made upon the basis of approximately a five-year

return; that is to say, for a price five times the annual earning capacity. There are, therefore, satisfactory comparatives in the event that it is desired to treat other cases where there have been no sales as special cases under sections 327 and 328, since the cash paid for tangibles and intangibles affords a fair invested capital basis. It also seems reasonable to regard those cases where large sums have been spent in advertising, thereby creating a good will or earning capacity far in excess of recognizable invested capital, as being cases in which there are abnormal conditions affecting invested capital.

The Committee, therefore, recommends that the percentage of tax to income in the cases of those corporations which have an adequate recognizable invested capital be determined, and that other cases which have no such invested capital be regarded as coming within the scope of section 327 and the tax properly to be computed under section 328.

3

8-21-1472: A. R. R. 394.

Recommended that a corporation which issued bonds at a discount in January, 1900, and elected then to charge such discount to profit and loss for the year of issue and the next two succeeding years, may not now revise its accounts and file amended returns for the purpose of reinstating to invested capital the unexpired portion of such discount and claiming as a deduction from income that portion applicable to each year.

It appears from the records that the M Company issued bonds on January 1, 1900, to the amount of 70x dollars at a discount of 7x dollars and charged such discount to profit and loss in 1900, 1901 and 1902.

The accountants writing in behalf of the corporation stated that it was their understanding that for the purpose of computing net income the case was covered by article 544 (3) (a) of Regulations 45. The M Company in its appeal contends, in effect, that it did not follow good accounting practice in charging off the discount in question to profit and loss during the years 1900, 1901, and 1902; that recognized accounting authorities, some of whom are named and quoted, hold that discount on bonds issued should be spread over the term of the bonds, and the installments thereof charged against income each year, and that, under article 544, it did not have an option of treating all of such discount as interest expense at the date of issuance of the bonds.

Article 544 (3) (a) of Regulations 45, reads:

If bonds are issued by a corporation at a discount, the net amount of such discount is deductible as interest and should be prorated or amortized over the life of the bonds.

The Unit, in its reply of June 30, 1920, contended that article 544(3) (a) must be considered in connection with article 841, which latter article, bearing the caption "Surplus and undivided profits: limitations of addition to surplus account," provides, in part, that deductions which have been taken from income and which are as a matter of good accounting to some extent optional, such as experimental expenses, patent litigation, development of good will through advertising or otherwise, can not be reinstated in surplus, as in such cases it is considered that the corporation has exercised a binding option in deducting such expenses from income, and an election of this sort which was made concurrently with the transaction can not now be revised and amended returns in respect thereto can not be accepted.

The Solicitor of Internal Revenue, in a memorandum dated May 13, 1919, commenting on a ruling in a case similar to the one under consideration stated:



It appears that the corporation in this case had an option as to the method it would adopt in handling entries of the discount on the bonds which it issued. Two methods were available:

First. To treat the discount as interest paid in advance to be amortized over the life of the bonds.

Second. To charge the discount as a loss in its profit and loss account.

The corporation exercised its option by adopting the second method. It did so apparently to lessen its income for the year the transaction took place. It now seeks to adopt the first method and desires to amend its 1917 return accordingly. The effect of this procedure would be that the discount item would be taken from the losses (profit and loss account), thus diminishing the losses and thereby increasing its surplus account, and indirectly its invested capital.

Where a corporation has exercised an option as to accounting practice and such option was concurrent with the transaction, amended returns are not permissible. See article 841 of Regulations 45.

While the Committee is in accord with the contention of the M Company that it did not follow the more generally approved accounting method in charging off the discount on its bonds of January 1, 1900, as it did, that fact alone does not entitle it now to adopt another method and adjust its accounts for the purpose of filing amended income and profits tax returns. There were at the time said bonds were issued no income tax regulations prescribing a method to be followed in the treatment of bond discount. It was entirely optional with the taxpayer as to the method it would adopt in handling entries of discount on bonds issued, and inasmuch as that option was exercised at the time the bonds were issued a different method of accounting can not now, in the opinion of the Committee, be adopted for tax purposes, which opinion is sustained by the decision in the case of the *C. & A. Railroad v. United States Court of Claims* (see article 149, Regulations 33, revised, issued under the provisions of the Revenue Act of 1916, as amended by the Revenue Act of 1917).

The Committee, therefore, recommends that the ruling of the Unit be sustained.

4

I-23-336: I. T. 1347

#### Revenue Act of 1918.

If a corporation employed its own labor in the construction of its plant, such as building of machine foundations and in the installation and assembling of machines and other equipment, the value of the labor so employed represented a capital expenditure which may be included in invested capital. If the value of such labor was deducted as an expense in excise and income tax returns for years prior to 1917, it may be restored to invested capital at its depreciated value, provided amended returns are filed for each year during which a deduction from income was made, in which returns the amended net income shall be increased by the value of the labor previously deducted as an expense.

5





**Section 326.—Invested Capital (1918 Act—¶555, ante): (1921 Act—¶1035, post).**

**Article 843.—Surplus and Undivided Profits (Reg. 45—¶776, ante): (Reg. 62—¶1209, post).**

47-20-1312: A. R. M. 95.

**REVENUE ACT OF 1917.**

The Committee has had under consideration the appeal of the M Company, from the action of the Income Tax Unit in disallowing for the taxable year 1917, an item of 50x dollars covering depreciation on certain patents.

In January, 1902, the M Company, then a newly organized corporation, acquired ownership of eight patents issuing therefor to A, the patentee 900x dollars of stock of the corporation. This amount was subsequently increased 2x dollars by expenses of acquisition. The patents so acquired, except one, issued in 1900, had expired prior to January 1, 1917, but as of March 1, 1913, all but one were in effect. Fifteen new patents had, however, been added to the company's patents between date of incorporation and March 1, 1913. These additional patents were not capitalized. No depreciation was taken by the taxpayer on the patents which were capitalized, until the year 1917, when 1/17 of the book value was charged to expenses notwithstanding the fact that all except one of them had expired prior to January 1, 1917.

The taxpayer relies upon articles 167 and 843 of Regulations 45, and upon Treasury Decision 2929, amending article 163 of Regulations 45, in support of his action.

It is assumed the actual value at date of acquisition of the patents by the issuance of stock has been determined by the Income Tax Unit, since this question is not at issue before the Committee.

The case then comes clearly under the provisions of article 174, paragraph 552, and article 167, paragraph 494, Regulations 33, revised, governing the collection of the income tax imposed by the Revenue Act of 1917.

**Article 174, paragraph 552, provides:**

An allowable deduction for any given year for return of capital invested in patents at time of issue, will be an amount equal to 1/17 of the actual cost in cash or its equivalent of such patents.

This paragraph of article 174, was subsequently amended by Advisory Tax Board Recommendation 59, September 9, 1919, to provide as follows:

Depreciation of patents acquired prior to March 1, 1913, should be taken on the basis of their fair market value as of that date, if affirmative and satisfactory evidence of such value is offered.

**Article 167, paragraph 494, provides:**

Good will represents the value attached to a business over and above the value of the physical property and is such an intangible asset that it is not subject to wear and tear and no claim for depreciation in connection therewith can be allowed. Any loss resulting from or on account of investment of good will can be determined only when the property or business to which the good will attaches, is sold or disposed of, in which case the profit or loss will be determined upon the basis of the value of the assets, including good will, if acquired prior to March 1, 1913, or their cost if acquired subsequent to that date.

The basis for deduction authorized under the provisions of article 174 is the return of capital on an asset, the use of which in the trade or business is definitely limited in duration. The taxpayer did not elect, during the life of the patents acquired in 1902, to provide for this return of capital. Had he made this provision his surplus for invested capital purposes under the Revenue Act, would have been correspondingly reduced.

He, therefore, can not now claim in a high taxable year, after the expiration of the life of the patents, an amount equivalent to 1/17 of the cost, thereby securing the benefit not only of a reduction in his taxable income

for the year 1917, but the advantage of the investment which in value is subject only to the definite limitations prescribed by the Act and the regulations.

The Committee therefore sustains the action of the Income Tax Unit in disallowing the item of 50x dollars claimed by the taxpayer in the taxable year 1917, as a deduction based on 1/17 of the cost of said patents.

1

13-21-1536: A. R. R. 436

Recommended that 48x dollars be allowed as the value of patents acquired for stock on the basis that the preferred stock was worth par and the common about one-third of par per share as disclosed by collateral stock market quotations at the date of the organization of the M Company in 189— and that the invested capital should not be reduced by the value of patents expired.

The Committee has had under consideration the appeal of the M Company, from the action of the Unit in reducing the company's invested capital for 1917.

A single issue is presented in the appeal, namely, the amount of invested capital represented by patents acquired on organization of the company in 189—, but this issue has two aspects: (1) Whether or not the company is entitled to any invested capital by reason of the original issue of stock for patents which have long since expired, and (2) what was the value of the patents at the time of organization.

The stock of the M Company was issued for stock of five other companies but under the authority of Regulations 41, as amended by Treasury Decision 2901, the Income Tax Unit has considered the acquisition of all of the stock of these five companies as being in effect the acquisition of their assets, and it has therefore gone behind the acquisition of stock to determine the character of the various groups of assets acquired. One of the principal groups is patents, and the question of the value of such patents at the time therefore becomes material.

The company has filed numerous affidavits and statements claiming a value of 72x dollars, representing the par value of the stock issued therefor. In the opinion of the Committee, however, appraisals, either by a board of directors at the time of purchase, which notoriously fixes the value as equal to the par value of the stock issued therefor irrespective of actual market value of assets so acquired, or by individual appraisers at a later date, are not so reliable as those made by the public at the time through the purchase and sale of the stock at or about the time of issuance.

The Unit has filed a supplemental memorandum made subsequent to the hearing of the case in which it gives a valuation on the basis of collateral stock market transactions at the date of the organization of the company as 36x dollars. This accords very closely with its revised valuation on the basis of royalties, which is 37x dollars, and in the light of earnings appears to be a much more reliable estimate of value than that claimed by the company. The value of the patents is fully demonstrated by prior earnings of the predecessor corporations and is supported by the earnings subsequent to date of acquisition by the present owner.

However, at a meeting of the board of directors in April, 1899, at which the president submitted certain correspondence with the N Company in reference to the particular business, it appears that the promoters agreed to subscribe to or cause to be subscribed to y shares of the preferred stock *at par, that such stock was subscribed to at par and the amount received therefor paid into the treasury of the company as working capital.* The balance of the



shares of stock issued,  $7y$  shares preferred of the par value of  $35x$  dollars, and  $8y$  shares common of the par value of  $40x$  dollars, was paid over to the various companies for their assets, which consisted chiefly of patents. It is reasonable to assume that since outsiders subscribed for  $y$  shares of preferred stock at par and paid  $5x$  dollars cash into the treasury of the company, the remaining shares of the preferred stock were worth par.

No evidence has been submitted to show that any of the shares of common stock were sold to the public prior to or at the date of organization of the new company. However, it is disclosed that the shares of common stock were selling on a stock exchange soon after the new company has been organized at about one-third of par per share. Accepting this as a basis, the  $8y$  shares of common stock issued to the various companies had a fair market value of  $13x$  dollars. Arguments and affidavits have been submitted and numerous court decisions have been cited to substantiate the claim that the judgment of the board of directors fixing the value of the patents acquired at approximately  $75x$  dollars represented a true value of such patents.

The Committee can not concur in this contention for the reason stated above and, therefore, recommends that the value of the assets (patents) acquired be fixed at  $48x$  dollars, such valuation being based on the theory that if  $y$  shares of the preferred stock were sold for par and the cash paid into the treasury of the company, the remaining  $7y$  shares were worth par and the assets transferred in exchange for these shares were worth  $35x$  dollars. No better evidence being available, the collateral transactions in the common stock soon after the organization of the corporation at about one-third of par per share have been accepted as establishing the value of the common stock paid over to the various corporations in part payment for the patents in question.

The Committee, therefore, recommends that  $48x$  dollars be regarded as the value of the patents at the time of acquisition.

The next question is whether or not the company is entitled to retain this full valuation in its invested capital, notwithstanding the patents have expired.

At the outset it must be recognized that invested capital originally paid in can be reduced under only one condition—that is, that it has been returned to the stockholder through liquidation. The loss of the original capital or its exhaustion in the business does not alter its recognizable status. The only thing which can be affected by an exhaustion of capital is the earned surplus, which may be adjusted, if necessary, to cover any loss or exhaustion of original values.

The Unit in treating this case recognized the principle in article 843 of Regulations 45, namely, that patent values gradually merge into good will. It has sought, however, to apply the 20 per cent limitation provided by section 207 of the Revenue Act of 1917 to the good will so created. In the opinion of the Committee this application is not warranted by law, since under the express terms of the statute it is applicable only where good will is acquired for stock.

As stated in Regulations 45 and in several of the decisions of the Advisory Tax Board and the Tax Reviewers, patent value is closely analogous to good will, both in fact representing the estimated worth of a monopoly—in one case a monopoly created by law; in the other a monopoly due to circumstance.

In Tax Reviewers' Recommendation 1 (not published), approved by the former Commissioner, it was held as follows:

From the standpoint of assets a patent, and more particularly a group of patents, is closely analogous to good will. Their value is contingent upon and measured by their earning power, and whilst patents have a definite life there is a common tendency to extend that life by improvements upon the original patent, and in a successful business the patent value merges more or less completely into a trade name or other form of good will. Therefore whilst deductions in respect of depreciation of patents based upon a normal life period of seventeen years are allowable in computing net income under the several income tax Acts, such deductions are not obligatory, but are optional with each taxpayer. Where, since January 1, 1909, a taxpayer has exercised that option to his own benefit in computing his taxable net income, an amount so deducted can not now be restored in computing invested capital. Where the cost of patents has been charged against surplus or otherwise disposed of in such a manner as not to benefit the taxpayer in computing his taxable net income since January 1, 1909, any amount so written off may be restored in computing invested capital if it be shown to the satisfaction of the Commissioner that the amount so written off represented a mere book entry ascribable to a conservative policy of management or accounting and did not represent a realized shrinkage in the value of such assets. Any amount so restored may not be written off by way of deductions from taxable net income in any subsequent year or years. Where a taxpayer has charged to current expenses the cost of developing or protecting patents, no amount in respect thereof expended since January 1, 1909, can be restored in computing invested capital, and in respect to expenditures made prior to January 1, 1909, the taxpayer now seeking to restore them must be prepared to show to the satisfaction of the Commissioner of Internal Revenue that all such items are proper capital expenditures.

The correct computation of surplus and undivided profits can not be said to require a deduction in respect of expiration of patents, and it follows therefore that where a taxpayer in the exercise of his option has not written down the cost of patents, it is unnecessary to reduce the surplus and undivided profits in computing invested capital whether the patents have been acquired for stock or shares or for cash or other tangible property. Due consideration will be given to the facts in any case in which the foregoing rule is obviously unreasonable.

This conclusion is supported by Advisory Tax Board Memoranda 17 and 22 (not published), and is not inconsistent with articles 839 and 840 of Regulations 45. There is no warrant in the law or regulations for reducing earned surplus by an amount greater than is necessary to make good the impaired cost of the original asset.

The Committee therefore recommends that the value herein fixed as the original value of the patents at the time paid in for stock be recognized in the invested capital for the year 1917.



Law Section 326.—Invested Capital (1918 Act—§555, ante): (1921 Act—§1035, post).

Article 844.—Surplus and Undivided Profits. Reserve for Depreciation or depletion (Reg. 45—§778, ante): (Reg. 62—§1210, post).

7-19-308: T. B. M. 41.

The claim of the X Company for the inclusion in its invested capital for the year 1917 of the amount of 6x dollars, representing appreciation in the value of its property, which appreciation had been taken up on its books in 1914 and returned as taxable income for that year, should be denied for the reason that such tax was erroneously assessed and collected. The taxpayer is entitled to a claim for refund.

Reference is made to the claim of the X Company for the inclusion in its invested capital for the year 1917 of an amount of x dollars representing appreciation in the value of a certain part of its property which was taken up on the books in 1914 and returned as a part of its taxable net income for that year, in accordance with article 107 of Regulations 33, which reads as follows:

Art. 107. It will be noted from these definitions that the gross income embraces not only the operating revenues but also income, gains, or profits from all other sources, such as rentals, royalties, interest and dividends from stock owned in other corporations, and appreciation in values of assets if taken up on the books of account as gain; also profits made from the sale of assets, investments, etc.

This item was brought to the attention of the Bureau during 1918 and was disallowed in the computation of invested capital for the year 1917. An appeal was made to the Advisory Tax Board, but no evidence has been found that would warrant a change in the original decision of this office.

Regulations 33, from which article 107 is quoted above, were issued in January, 1914, and in March, 1915, the question of the taxability of appreciation of property when taken up on the books of a taxpayer was decided adversely to the Government by the United States Circuit Court of Appeals in the case of the Baldwin Locomotive Works v. McCoach, Collector (221 Fed., 59). This decision was embodied in Treasury Decision 2185, issued April, 1915, which held that an "increase in the valuation of assets on the books of the corporation is not income received during the year, where there is no addition to the plant and all that was done was to revalue the property." It appears, therefore, that the return for 1914 was made in accordance with the regulations of the department, but that shortly after the filing of the return the court decision above mentioned made it necessary for the Treasury Department to rescind the provisions of article 107, of Regulations 33, in so far as they related to the taxation of unrealized appreciation. Between April 1, 1915, and the date upon which the tax for 1914 became due and payable a claim might have been filed for abatement of the proportion of the tax represented by the item of appreciation, and since the date of the payment of the tax the company was entitled to file a claim for refund. This right continues for a period of five years from date upon which the return was due.

The computation of invested capital for the year 1917 is to be determined in accordance with the provisions of the Act of October 3, 1917, and Regulations No. 41, issued thereunder. In article 42 of these Regulations it is provided, *inter alia*, that—

If value appreciation of a kind not subject to income tax (other than that allowed under article 55) has been taken up on the accounts, a deduction must be made in respect of such appreciation so taken up.

As shown above, the appreciation written up on the books in 1914 was not properly subject to income tax. The exception to this rule as found in article 55 referred to in the quotation above reads as follows:

Tangible property paid in for stock or shares prior to January 1, 1914, must be valued

at either (a) the actual cash value of such property on January 1, 1914, or (b) the par value of the stock or shares specifically issued therefor, whichever is lower.

This regulation is based upon the statutory provision defining invested capital, which is found in section 207 (a) (2) of the Act of October 3, 1917:

The actual cash value of tangible property paid in other than cash, for stock or shares in such corporation or partnership, at the time of such payment (but in case such tangible property was paid in prior to January 1, 1914, the actual cash value of such property as of January 1, 1914, but in no case to exceed the par value of the original stock or shares specifically issued therefor).

This provision of the law does not allow for any general appreciation of property as at January 1, 1914, and the inclusion of appreciation in invested capital is limited in effect to cases where capital stock has been issued specifically in payment for tangible assets in an amount which at par exceeded the actual cash value of the property at the date of the transaction, but where between such date and January 1, 1914, the property had appreciated in value. In such a case appreciation in an amount not in excess of the difference between the actual cash value of such property at the date of its acquisition and the par value of the stock issued specifically for the property may be included in invested capital. The case does not come within this exception.

The claim for inclusion in invested capital of  $x$  dollars representing appreciation in value of property can not be allowed.

1

II ('23)-25-1113: I. T. 1791.

### Revenue Acts of 1918 and 1921.

Mere appreciation in value of property may be considered as an earning only as of the time it is realized. Consequently, it must be excluded from the computation of invested capital for the year in which it is realized as "surplus earned during the year" and may affect invested capital no sooner than the beginning of the year immediately following such realization.

Advice is requested as the computation of invested capital of the M Company.

It appears that this corporation has property on which it is entitled to compute depletion on its value as of March 1, 1913. The question (as stated in taxpayer's brief) is—

Does the proportion of such depletion that represents a realization of appreciation accrued at March 1, 1913, result in "surplus and undivided profits earned during the year" of realization and should such realized appreciation affect invested capital from the beginning of the succeeding fiscal year or from the time actually paid in?

Simplifying the inquiry, it means, in its essence, When may realized appreciation be considered as affecting invested capital?

The 1918 and 1921 Revenue Acts (section 326(a)3) define the term "invested capital" to include:

\* \* \* paid in or earned surplus; not including surplus and undivided profits earned during the year.

Article 844 of Regulations 45 and Regulations 62 provides:

Where depreciation or depletion is computed on the value as of March 1, 1913, \* \* \* the proportion of depreciation or depletion representing the realization of appreciation of value at March 1, 1913, \* \* \* may if undistributed and used or employed in the business be treated as surplus and included in the computation of invested capital.

Counsel for the taxpayer argues upon the authority of the cases of *Gray v. Darlington* (15 Wall., 63), *Doyle v. Mitchell Bros.* (247 U. S., 179), *Mercer v. Buchanan* (132 Fed., 501), and *Southern Pacific R. R. Co. v. Lowe* (247 U. S., 330) that appreciation is *earned* when it occurs and not during the year



of realization. The cases cited may, with as much, if not more, propriety, however, be employed to support the opposite theory. For instance, in *Gray v. Darlington, supra*, it is said:

Mere advance in value in no sense constitutes the gains, profits, or income specified by the statute. It constitutes and can be treated merely as an increase of capital.

Surely this is no authority to say that appreciation is *earned* when it occurs. Likewise, in *Southern Pacific Co. v. Lowe, supra*, the distinction is not overlooked as to "surplus earnings" and "the increment due to an appreciation"—though both are in effect classed together as far as the distinction between "capital" and "income" is concerned. However, such observations as are pointed out in the cases of *La Belle Iron Works v. United States* (256 U. S., 377), affirming the decisions in 55 Ct. Cl., 462, are beside the point when it is recalled that we are not here interested in the distinction between *capital* and *income*, but in a definition of the term "invested capital." And so, too, is the argument sought to be supported by article 1543 of Regulations 62, which, of course, is concerned with "dividends" and, as may be later seen, is more properly persuasive of a conclusion opposite to that contended for.

The court in the *La Belle Iron Works* case (*supra*) had under consideration the 1917 Revenue Act, which contained the following (section 207 (a)3) in its definition of invested capital:

\* \* \* paid in or earned surplus and undivided profits used or employed in the business, exclusive of undivided profits earned during the taxable year.

In passing upon the contention that the increased value of ore lands ought to be included in invested capital as "paid in or earned surplus and undivided profits" the court says:

Section 207 shows that Congress was fully alive to this and designedly adopted a term "invested capital" and a definition of it that would measurably guard against inflated valuations. The word "invested" in itself imports a restrictive qualification. When speaking of the capital of a business corporation or partnership, such as the Act deal with, "to invest" imports a laying out of money, or money's worth, either by an individual in acquiring an interest in the concern with a view to obtaining income or profit from the conduct of its business, or by the concern itself in acquiring something of permanent use in the business, in either case involving a *conversion of wealth from one form into another suitable for employment in the making of the hoped-for gains*. See Webster's New International Dictionary, "Invest," 8; Century Dictionary, "Invest," 7; Standard Dictionary, "Invest," 1. (*Italics supplied.*)

The provision of clause (3) that includes "paid in or earned surplus and undivided profits used or employed in the business" recognizes that in some cases contributions are received from stockholders in money or its equivalent for the specific purpose of creating an actual excess capital over and above the par value of the stock; and, in view of the context, surplus "earned" as well as that "paid in" excludes the idea of capitalizing (for the purposes of this tax) a mere appreciation of values over cost. \* \* \*

\* \* \* it was not improper to attribute the entire \$9,914,400 added to the book value of the ore property in the year 1912, to a mere appreciation in the value of the property; in short, to what is commonly known as the "unearned increment," not properly "unearned surplus" within the meaning of the statute.

The application of the principles enunciated in this case to the present inquiry, when regard is had to a reasonably precise understanding of the words used, is comparatively simple.

Etymologically, the word "earn" is akin in its sense to "reap" or "harvest" and is in its present meaning defined as "to acquire by labor, service, or performance." In its transitive use the verb "realize" means "to make real," a sense which is carried into the intransitive verb which is defined as "to convert an intangible right or property into real (tangible) property; hence, to convert any kind of property (considered as fluctuating or uncertain in value) into money." Webster's New International Dictionary.

Appreciation, as is indicated in the *La Belle Iron Works* opinion, is a term almost antithetic in its connotations to "earning," which implies

something more than mere passive acceptance of an advance in value. It is a "lazy" income, as contrasted with "industrious," to use the famous Gladstone expression; "precarious," as differing from "realized," in Seligman's language. Clearly, therefore, appreciation may not be said to be "earned" until something is done, "some labor, service, or performance" whereby that which before was but a nebulous, albeit probable, gain, is made real. And just as clearly, it seems the act which earns appreciation is that of converting it into a form of wealth "suitable for employment in the making of the hoped-for gains"; that is, its "realization." The conclusion, of course, is inevitable that appreciation can be said to be "earned" only at the time it is realized.

Throughout the law and regulations this distinction is seldom lost sight of. It may be noted, as an example, how in article 1543, Regulations 62, cited by counsel for taxpayer, care is taken to specify, in speaking of distributions out of earnings or profits accumulated prior to March 1, 1913, "increase of value of property accrued," thus in effect acknowledging that appreciation is not an earning before realization. Manifestly, appreciation is earned not when it accrues but during the taxable year of its realization; and under the statute and regulations cited it can affect invested capital no sooner than the beginning of the fiscal year immediately following its realization.

2. It is further to be noted that the Regulations, in article 1543, cited by counsel for taxpayer, care is taken to specify, in speaking of distributions out of earnings or profits accumulated prior to March 1, 1913, "increase of value of property accrued," thus in effect acknowledging that appreciation is not an earning before realization. Manifestly, appreciation is earned not when it accrues but during the taxable year of its realization; and under the statute and regulations cited it can affect invested capital no sooner than the beginning of the fiscal year immediately following its realization.



**Law Section 326.—Invested Capital (1918 Act—¶555, ante): (1921 Act—¶1035, post).**

**Article 845.—Surplus and Undivided Profits; Reserve for Income and Excess Profits Taxes (Reg. 45—¶782, ante): (Reg. 62—¶1214, post).**

5-19-265: T. B. R. 17.

**Treasury Decision 2791 and article 845 of Regulations should not be modified.**

Numerous protests against the validity of the principle first adopted in Treasury Decision 2791, approved February 17, 1919, and subsequently embodied in Article 845 of Regulations 45, have been made. A hearing upon the question was held before the Advisory Tax Board at the request of the X Company, at which time its general counsel appeared and argued against the power of the Commissioner to make this regulation, which requires that surplus and undivided profits as of the end of the preceding year must be reduced as of the date or dates when Federal income and excess profits taxes become due and payable, by the amount of such taxes for that year.

In the original and supplemental memoranda filed by the X Company counsel has set forth at length the several arguments of greater or less weight in support of the position urged by that taxpayer.

In the opinion of the board the Commissioner and Secretary in promulgating Treasury Decision 2791 and article 845 have placed the whole matter upon what is the only basis which accords with the requirements of the statute and meets the demands of proper accounting, although it is true that the arguments advanced by counsel for the taxpayer in this case are well presented and at first blush seem convincing and persuasive.

**Article 845 of Regulations 45 provides:**

For the purpose of computing invested capital, Federal income, and war profits and excess profits taxes are deemed to have been paid out of the net income of the taxable year for which they are levied. It is immaterial, therefore, whether reserves for the payment of such taxes for the preceding year have been set up or not, or if set up whether such taxes when paid have actually been charged against such reserves. Amounts payable on account of such taxes for the preceding year may be included in the computation of invested capital only until such taxes become due and payable. A deduction from the invested capital as of the beginning of the taxable year must therefore be made for such taxes or any installment thereof, averaged for the proportionate part of the taxable year after the date when the tax or the installment is due and payable.

The provisions of Treasury Decision 2791 relating to the tax under Title II of the Revenue Act of 1917 are substantially the same.

The relevant provisions of the statute are found in section 207 of the Revenue Act of 1917—

As used in this title "invested capital" does not include \* \* \* money or other property borrowed, and means, subject to the above limitations: \* \* \* (3) paid in or earned surplus and undivided profits used or employed in the business, exclusive of undivided profits earned during the taxable year.

and in section 326 of the Revenue Act of 1918—

Sec. 326. (a) That as used in this title the term "invested capital" for any year means \* \* \* (3) paid in or earned surplus and undivided profits; not including surplus and undivided profits earned during the year; \* \* \* but (b) as used in this title the term "invested capital" does not include borrowed capital.

The term "earned surplus and undivided profits" used in both acts is brief but full of import. In effect, it incorporates into the law by reference the entire body of principles of accounting relative to the determination of surplus. There is in neither act any provision defining this term or modifying what must otherwise be accepted as the guiding principle to be applied in determining what is surplus. The statute, therefore, requires that the surplus in any case shall be determined exactly in accordance with the accepted principles of accounting; and it is to those principles that both the

taxpayer and the Government must turn for light upon the meaning of this provision of the law.

The application of these principles to the question at issue brings a speedy response and permits of only one answer. A tax levied as these taxes are, for a definite period, must be considered as a liability which has fully accrued at the end of that period; and if not already paid, provision for its payment must be made before there can be any true surplus or undivided profits. This is especially true in the case of an income tax—and excess and war profits taxes are income taxes—which must be considered as a sharing by the Government in the income of the taxpayer for the taxable year. The fact that the tax is in terms of the statute imposed “upon” the net income and that there is no specific provision that it is to be paid “out of” net income can not change its inherent nature.

The amount of these taxes for any year can not, therefore, after the conclusion of such year be considered as a part of the surplus, but is rather in the nature of a liability, and if this regulation is open to criticism at all, such criticism might much more properly be directed against its further provision permitting the amount of such tax to be included as surplus until such time as the tax becomes due and payable.

It is true that in every case the situation is not such that it will be vitally affected by a failure to apply sound principles, and as a result the development of the rulings already referred to as unsound was very easy, but when the situation happens to be such that the effect of the application of a wrong principle would be critical the difference between the sound and the unsound principle is apparent at once. A single example will suffice to illustrate what is meant: Thus, if a business continues to be owned from year to year by substantially the same interests it becomes relatively unimportant whether such taxes are charged against the income upon which they are levied or against other funds; but if the control of that business changes hands and it thus becomes important to charge the taxes against the proper funds, there would never be any question but that they are properly chargeable against the income for which levied. The purchaser would never for a moment admit that they might equally as well be charged against his future earnings or that he should become liable to raise them by borrowing from the bank or otherwise, without allowance being made in the consideration which he pays for the business.

In the opinion of the board the provisions quoted above from section 207 of the Revenue Act of 1917 and from section 326 of the Revenue Act of 1918 are controlling and sustain the interpretation which has been embodied in the form of a regulation in Treasury Decision 2791 and in article 845 of Regulations 45. It is accordingly recommended that no modification in these regulations be made.

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 11-19-392: O. D. 222.

The rule expressed in article 845, Regulations 45, that taxes are deemed to be paid out of earnings for the year for which levied, applies to any year of the prewar period as well as to the taxable year. In such cases the amount or amounts payable in a succeeding year on account of such taxes may be included in the computation of invested capital until due and payable.

2



12-19-411: T. B. M. 51.

Effect of assessment of additional income and excess profits taxes for prior years upon invested capital.

The rulings contained in Treasury Decision 2791 and article 845 of Regulations 45 require income and excess profits taxes levied for the particular year to be considered as liabilities which have accrued at the end of such year and which must be taken into account in determining the surplus and undivided profits which may thereafter be included in invested capital, and state that such taxes may be included in the surplus until they become due and payable. These rulings are in general applicable to additional assessments.

It is the essence of any system of accrued accounting that items of income and outgo be estimated as they accrue and that the proper entries be made upon the books at that time. The books for any fiscal period are deemed to clearly reflect the history of that period and are not changed even though subsequent events demonstrate that certain accruals, to a minor degree, were incorrectly estimated. The necessary adjustments to correct such errors are made in the current accounts. It is only where major adjustments are necessary that it is good accounting practice to make adjustments for past errors in the surplus account.

For these reasons the Advisory Tax Board recommends that additional assessments of income and excess profits taxes, for prior years which are relatively small or unimportant be considered paid from current earnings; but that where the additional assessment is relatively large and important such assessment be considered a liability of the taxable year in question and that the necessary adjustments of the surplus account be made. In such cases the phrase "due and payable" in article 845, Regulations 45, means the due date for taxes of the taxable year and not the date fixed for the payment of the additional assessment.

It is suggested that in all cases in which the additional assessment is less than 5 per cent of the original assessment or is less than \$5,000 it be considered paid out of current earnings and that no adjustment of invested capital be made.

3

11-20-788: O. D. 410.

Where a corporation has filed a claim for determination of war-profits and excess profits tax for 1918 under section 328 and has made payments on the basis of 50 per cent of the net income, the claim not having been acted upon when its 1919 return is due, the invested capital for 1919 should be adjusted on the basis of the tax payments actually made, subject, however, to readjustment when the correct amount of tax for 1918 is determined.

4

45-20-1299: A. R. M. 87.

Held in the case of corporations which filed returns for a fiscal year ended June 30, 1917, under the Revenue Act of 1916, and the tax thereon became due and payable on December 12, 1917, that the additional taxes imposed by the Revenue Act of 1917 shall be deemed to be due and payable on the same date.

The Committee is in receipt of a memorandum from the Income Tax

Unit in which advice is requested as to the basis on which invested capital should be adjusted in connection with a corporation's income and excess profits taxes for the fiscal year ended June 30, 1917. This adjustment is necessary in order to determine the correct invested capital of the corporation for the fiscal year ended June 30, 1918.

The point on which advice is sought resolves itself into the question of when the income and excess profits taxes for the fiscal year ended June 30, 1917, were due and payable. It appears that under the Revenue Act of 1916 corporations having a fiscal year which ended June 30, 1917, were required to file returns sixty days after the close of the fiscal year and that the taxes became due and payable 105 days after the due date of the return. A corporation having a fiscal year ended June 30, 1917, was required to file a return on Form 1031 under the Revenue Act of 1916 and also an excess profits tax return on Form 1095 under the provisions of the Act of March 3, 1917, sixty days after the close of the fiscal year. The taxes as shown by these returns became due and payable on December 12, 1917, and in determining the invested capital of the corporation for the fiscal year ended June 30, 1918, the invested capital would be reduced by the above taxes prorated from December 12, 1917, to June 30, 1918.

In addition to the above returns it was necessary for the corporation to file supplemental returns covering the additional income and excess profits taxes imposed by the Revenue Act of 1917. The time for filing the supplemental returns in question was extended by various Treasury Decisions to March 1, 1918; hence the question presents itself as to when such taxes should be considered due and payable in adjusting the capital for the fiscal year ended June 30, 1918.

In order to pass upon the question presented it is necessary to examine the provisions of the law and regulations on this point. Section 212 of the Revenue Act of 1917 reads as follows:

That all administrative, special, and general provisions of law, including the laws in relation to the assessment, remission, collection, and refund of internal revenue taxes not heretofore specifically repealed, and not inconsistent with the provisions of this title are hereby extended and made applicable to all the provisions of this title and to the tax herein imposed, and all provisions of Title I of such Act of September 8, 1916, as amended by this Act, relating to returns and payment of the tax therein imposed, including penalties, are hereby made applicable to the tax imposed by this title.

Section 14(c) of the Revenue Act of 1916 reads in part as follows:

\* \* \* Provided, That the Commissioner of Internal Revenue shall have authority, in the case of either corporations or individuals, to grant a reasonable extension of time in meritorious cases, as he may deem proper.

It was under this provision of the statute that the various extensions were granted by the Commissioner for the filing of the supplemental returns required by the provisions of the Revenue Act of 1917.

Section 14(a) of the Revenue Act of 1916 reads in part as follows:

All assessments shall be made and the several corporations, joint-stock companies or associations, and insurance companies shall be notified of the amount for which they are respectively liable on or before the 1st day of June of each successive year, and said assessment shall be paid on or before the 15th day of June: *Provided*, That every corporation, joint-stock company or association, and insurance company, computing taxes upon the income of the fiscal year which it may designate in the manner hereinbefore provided, shall pay the taxes due under its assessment within one hundred and five days after the date upon which it is required to file its list or return of income for assessment; \* \* \*

Reading this provision of the statute in connection with the facts submitted upon which advice is requested, and that part of section 13(a) which fixes the due date for filing returns, it appears that a definite date is fixed upon which the taxes of a corporation filing its returns upon the basis of a fiscal year become due and payable.

The question of reserves for taxes and the adjustment of invested capital



on account of such reserves was first considered by the Tax Reviewers and the following ruling is found in their minutes:

Reserves set aside out of surplus or undivided profits of preceding years for payment of Federal or State taxes not yet due can be included in invested capital for the taxable year if and to the extent that such taxes were not allowable deductions in computing net income for the preceding year.

Thus, if a taxpayer makes his return on an accrual basis, his State taxes which have accrued during the preceding year constitute allowable deductions for the preceding year, and hence can not be included in capital. But, if his return is on the cash basis, in which case such taxes are not deductible until paid, then reserves set aside for that purpose may be included in the invested capital.

Inasmuch as Federal income and excess profits taxes (irrespective of the accounting basis employed) are not deductible in computing the respective net incomes subject to such taxes, reserves set aside for the payment of such taxes may be included in invested capital.

On February 17, 1919, this ruling was, in substance, embodied in Treasury Decision 2791, which reads as follows:

For the purpose of determining invested capital under Title II of the Revenue Act of 1917, income and excess profits taxes shall be deemed to have been paid out of the net income for the taxable year for which such taxes are levied. Amounts payable on account of income and excess profits taxes for any year *may be included in computing surplus and undivided profits* for the succeeding year only for the proportionate part of the year represented by the period of time between the close of the taxable year and the date or dates upon which such taxes become due and payable.

The same principle is carried forward and is covered by articles 845 and 845(a) of Regulations 45.

The question of reserves for income and excess profits taxes and the effect of such reserves on invested capital was presented to the Advisory Tax Board for consideration. In Tax Board Memorandum 51 (ruling 12-19-411, p. 296, Cumulative Bulletin, December, 1919) the effect of assessment of additional income and excess profits taxes for prior years upon invested capital was discussed. The conclusion reached in this memorandum with respect to adjustments on account of additional assessments is, in the judgment of the Committee, sound and should be adhered to by the Unit.

Looking further it is noted that article 230 of Regulations 33, revised, provides in part as follows:

In the case of returns made on the basis of a calendar year, the corporations against which taxes are assessed shall be notified of the amount thereof on or before June 1 of each successive year, and the taxes shall be paid on or before June 15 of the year in which the assessment is made.

Corporations making returns on the basis of a fiscal year other than the calendar year shall be notified of the amount assessed against them on or before the last day of the 90-day period next following the date when the return was due, and the taxes *shall be paid within 105 days from the due date of the return.*

Any extension granted by the collector or Commissioner of the time within which to file returns *will not be construed to correspondingly extend the time for the payment of the tax.* If for any reason a return should not be made until the time fixed by law for the payment of the tax has passed, the tax assessed on the basis of such return shall be paid upon notice and demand.

Under the above-quoted provisions of the Revenue Act of 1916, it is noted that the Commissioner is authorized to grant extensions of time in certain cases, but nowhere is there found a provision of law whereby the Commissioner may extend the due date fixed by the Statute for the payment of taxes. In all cases where the taxes imposed by the Revenue Act of 1916, and the Excess Profits Tax Act of March 3, 1917, fall due after October 3, 1917, the total amount of such taxes, together with the additional income and excess profits taxes imposed by the Revenue Act of 1917, shall be deemed to become due and payable on the date fixed by the Statute; that is, 165 days after the close of the fiscal year ended in 1917.

Upon the statement of facts presented the Committee, therefore, is of

the opinion that the taxes imposed by the Revenue Act of 1916, the Excess Profits Tax Act of March 3, 1917, and the additional taxes imposed by the Revenue Act of 1917 were due and payable on December 12, 1917, in accordance with the above-quoted provisions of the Statute fixing the due date for the payment of taxes.

In view of the foregoing provisions of law and regulations, it is held that the invested capital of a corporation, the fiscal year of which ended June 30, 1918, shall be reduced by the amount of taxes imposed by the various Acts referred to above on December 12, 1917, prorated to the close of the fiscal year June 30, 1918.

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43-21-1889: O. D. 1079.

A taxpayer made an overpayment of income taxes for the year 1917 in 1918, which amount was refunded to him in the year 1921.

The question presented is whether the taxpayer may include in its invested capital the amount so refunded for the calendar year 1921.

Held, that under the provisions of article 845 of Regulations 45 the amount of tax overpaid for 1917 and refunded may be included in the invested capital of the taxpayer for 1918 and subsequent years.

6

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I('22)-13-191: I. T. 1261.

#### Revenue Act of 1921.

Invested capital is not reduced in those cases where taxes due on returns for previous years were not determined and assessed within the time limit prescribed by section 250(d) of the Revenue Act of 1921.

Where an excess payment of tax is credited or refunded, in accordance with the second proviso of section 252 of the Revenue Act of 1921, the amount of invested capital is increased by the amount so refunded, or, in case of a credit, by the amount so credited up to the date such overpayment is actually applied against additional taxes due.

7

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I('22)-30-432: I. T. 1400.

#### Révenue Act of 1921.

Advice has been requested as to the effect of Treasury Decision 3310 (Bulletin I-15-214, p. 11) on the invested capital of corporations subject to its provisions.

A case is cited of a corporation whose fiscal year ended June 30, 1921, and which is subject to additional tax under the Revenue Act of 1921. Information is desired as to whether this tax, which is payable in four installments commencing with May 15, 1922, has any effect upon the invested capital of the corporation for the fiscal year beginning July 1, 1921.

The tax due on the new return is not to be considered as an additional tax due under the Revenue Act of 1918, with reference to its effect upon invested capital, inasmuch as it is an original tax due under the Revenue Act of 1921, and as such has the effect of reducing the invested capital of the corporation for the fiscal year beginning in 1921 to the extent that it is due and payable during such taxable year. A deduction from invested capital as of the beginning of such taxable year must therefore be made for the installments of such tax becoming due and payable within the taxable year averaged in the usual manner.

8



**Revenue Act of 1921.**

I ('22) 51-643: I. T. 1532.

On January 1, 1921, the M Company's business was the property of an individual. On September 1, 1921, a corporation having the same name as that under which this business had been previously conducted took over the entire assets and liabilities of the business. The individual income tax return of the individual owner included the income from the business for the period from January 1 to August 31, 1921, while a corporation income and profits tax returns was filed by the corporation for the period from September 1 to December 31, 1921. In preparing an amended return in which the income from the business for the entire year was to be returned as the income of the corporation, under the provisions of section 229 of the Revenue Act of 1921, it was found that the withdrawal account of the former owner of the business for the period from January 1 to August 31, 1921, included an item paid by him to the collector of internal revenue in settlement of his individual income tax for the year 1920.

The question was raised as to whether the entire withdrawal account of the individual owner should be considered as a dividend paid to him by the corporation or whether the Federal income tax item should be eliminated from the withdrawal account and be considered as an item of Federal income tax paid and not as a dividend.

Held, that the item of the individual owner's withdrawal account representing the amount paid in discharge of his individual Federal income tax for 1920 should be prorated so as to represent amounts which will be proportionate to the amount of his net income for 1920 which was derived from the M Company's business and to the remaining amount of his net income which was derived from other sources, respectively.

The portion of the withdrawal made for income tax payment which is proportionate to the individual owner's net income derived from the M Company's business should not be considered as a dividend received by him from the corporation and it is not subject to tax as such. It is to be considered as a payment from the capital of the M Company's business as at December 31, 1920, and must be excluded from the amount of the assets received by the corporation in determining its invested capital at January 1, 1921.

The balance of the withdrawal made for the income tax payment which is proportionate to the individual owner's net income derived from sources other than the M Company's business, if any, is to be considered as a dividend paid by the corporation during 1921 and will be taxable as such.

All other funds withdrawn by the individual owner for personal use during the period from January 1 to August 31, 1921, must be considered as dividends paid to him by the corporation.

9

II ('23) 1-688: I. T. 1559.

**Revenue Act of 1921.**

A corporation suffered an operating loss during its first fiscal year which ended in 1920, but made a profit for the fiscal year ended in 1921, upon which it paid an income tax. This profit, however, was not sufficient to wipe out the operating loss of the preceding year.

The corporation is not required to reduce its invested capital for the fiscal year beginning in 1921 and ended in 1922 on account of the income-tax

payment made during such year, but is entitled to the full capital paid in as invested capital without reduction for the operating loss or for the income-tax payment.

In filing its return for the fiscal year begun in 1921 and ended in 1922, care should be taken to state in Schedule H of the return the reason why there is no adjustment of invested capital on account of the income-tax payment for the preceding year.

10

II(23)-27-1132: A. R. R. 2190.

### Revenue Act of 1918.

Upon the incorporation of a partnership on January 1, 1918, the corporation took over  $x$  dollars which had been set aside by the partnership out of earnings of 1917 for the payment of income and excess profits taxes for that year. The corporation used this amount in its business until June 15, 1918, the date payable.

Held, that the amount to be used by the corporation may be included in its invested capital from January 1, 1918, to June 15, 1918. I. T. 1582 (Sec. 325. Art. 813.—16, Ruling No. 10) revoked.

The Committee has had under consideration the appeal of the M Company from the action of the Income Tax Unit in eliminating from invested capital for 1918 the accrued profits of the predecessor partnership for 1917 and used by the taxpaying corporation as invested capital from December 31, 1917, to June 15, 1918, the date payable.

The taxpayer relies upon article 845, Regulations 45, which reads in part:

Amount payable on account of such taxes for the preceding year may be included in the computation of invested capital only until such taxes become due and payable.

It appears that earnings of the partnership for the year 1917 to the amount of  $x$  dollars were set aside for the payment of income and excess profits taxes for that year and upon the formation of the corporation on January 1, 1918, this amount was taken over by the corporation and used in its business until the date payable—June 15, 1918.

In view of the foregoing, the Committee is of the opinion that the amount so used by the appellant may be included in invested capital from January 1, 1918, to June 15, 1918.

It is therefore recommended, in the appeal of the M Company, that the action of the Income Tax Unit in this respect be reversed and the appeal be sustained.

KINGMAN BREWSTER,

*Chairman Committee on Appeals and Review.*

11



**Law Section 326.—Invested Capital (1918 Act—¶555, ante): (1921 Act—¶1035, post).**

**Article 846.—Surplus and Undivided Profits; Insurance on Officers (Reg. 45—¶787, ante): (Reg. 62—¶1215, post).**

7-19-309: O. D. 179.

The cash surrender value of a life insurance policy which, under article 846 of Regulations 45, constitutes surplus as at the beginning of the taxable year for invested capital purposes, retains its character as surplus even though the policy constituting the admissible asset upon the basis of which the surplus was determined, is terminated and paid.

1

41-20-1239: A. R. R. 229.

The M Company through its attorney contends that its invested capital should be increased as at December 31, 1916, by the cash surrender value of certain insurance policies carried on the life of its president. In this connection it appears that the corporation has regularly deducted as an operating expense for each year prior to 1917, the amount of premiums paid on such insurance policies and that on January 1, 1917, such policies had a cash surrender value of  $1\frac{1}{2}x$  dollars which it is urged should be restored to the invested capital of the corporation inasmuch as such amount, with the exception of  $x$  dollars, had been disallowed by the Income Tax Unit.

The question here presented for decision is whether the cash surrender value of the insurance policies on the lives of officers of corporations may be included in the computation of invested capital, irrespective of the fact that the premiums paid on such policies have been regularly deducted as an expense in the computation of the net income of the corporation for prior years. In this connection the Income Tax Unit interpreting article 846 of Regulations 45 has held that only the cash surrender value of policies of insurance upon the lives of officers of corporations attributable to premiums paid in prior years which have not been deducted as an expense can be included in the computation of invested capital.

The Committee desires to call to the attention of the Unit the following ruling stated in Tax Reviewers' minutes with respect to this question under the provisions of the 1917 Act:

As premiums paid by a corporation for insurance on the lives of its officers or employees payable to it can not be deducted as expenses in computing taxable income, such insurance policies shall be considered tangible property under article 47 of Regulations 41 and may be included as invested capital of such corporation at their cash surrender value at the beginning of the taxable year.

The above-quoted ruling made by the Tax Reviewers has been carried forward and the same, in substance, is stated in article 846 of Regulations 45. Considering the above-quoted ruling made by the Tax Reviewers in connection with article 846 of Regulations 45, the Committee is clearly of the opinion that the total cash surrender value of the policies in question should be restored to the invested capital of this corporation for 1917. On this point the Committee feels that the contention of the corporation is well taken and recommends that the action of the Income Tax Unit in reducing the invested capital by the amount of the cash surrender value of certain insurance policies carried on the life of the president of this corporation

be reversed and the amount of  $1\frac{1}{2}\%$  dollars be restored to the invested capital of the corporation.

2

49-20-1338: O. D. 745.

Where insurance is carried by a corporation on the life of an officer or employee, the policy may be included as an admissible asset and reflected in the surplus account at its cash surrender value, or if it has no cash surrender value then its loan value, as of the beginning of the taxable year.

3

47-21-1938: O. D. 1109.

The O Corporation took out a policy of insurance on the life of A, who had guaranteed the accounts of the corporation against the M Company. Subsequently A, by reason of the guaranty, became individually liable for the claims against the M Company. The O Corporation paid premiums on the policy and received a distribution of a 20-year surplus from the insurer in 1919. Upon the death of A, the O Corporation received the face value of the policy.

It is held that where insurance is taken out by a corporation on the life of the guarantor of a debt to the corporation, the surrender value of the policy can not be included in invested capital, but the premiums paid may be deducted as a business expense.

The amount received as a distribution of surplus by the insurance company should be treated as income and included in the gross income of the O Corporation for the year in which received, subject to both income and excess profits tax.

As the premiums paid are deductible as business expenses, the amount received on the policy in excess of the cash surrender value of the policy on March 1, 1913, must be accounted for as income of the year in which received.

4



**Section 326.—Invested Capital (1918 Act—¶555, ante): (1921 Act—¶1035, post).**

**Article 850.—Surplus and Undivided Profits; Current Profits (Reg. 45—¶803, ante): (Reg. 62—¶1219, post).**

(See 42-20-1252; Section 331, Article 941.) Current profits of dissolved corporation in connection with invested capital of successor corporation.

1

I ('22)-15-220: A. R. R. 853.

### Revenue Acts of 1916 and 1917.

Recommended, in the appeal of the M Company, that the action of the Income Tax Unit in assessing the excess profits tax for the fiscal year ended October 31, 1917, upon the basis of the full fiscal year, excluding from invested capital net earnings for the months of November and December, 1916, be sustained.

The Committee has considered the appeal of the M Company from the action of the Income Tax Unit in assessing the excess profits tax for the fiscal year ended October 31, 1917, upon the basis of the full fiscal year, excluding from invested capital the net earnings for the months of November and December, 1916.

Owing to a delay in the preparation of the blank forms of returns, the M Company was granted an extension of time for filing its return for the fiscal year ended October 31, 1917, and the original return covering the income for the entire fiscal year filed was on March 30, 1918. An amended return was filed on April 1, 1918, in which the tax upon the profits earned in the months of November and December, 1916, was computed at the flat rate of 2 per cent and for the 10 months of the fiscal year falling within the calendar year 1917 upon the basis of the invested capital shown as of January 1, 1917, including the net earnings for November and December, 1916. The Income Tax Unit computed the tax for the year in question upon the basis of the average invested capital for the full fiscal year and assessed an additional tax in the amount of  $x$  dollars. The claim for abatement of this additional tax was rejected under date of May 25, 1921, hence this appeal.

Under section 13(b) of the Act of September 8, 1916, the return of the appellant was due within 60 days after the close of its fiscal year.

Section 207 of the Act of October 3, 1917, provides that the term "invested capital" shall include among other things "paid-in or earned surplus and undivided profits used or employed in the business, *exclusive of undivided profits earned during the taxable year.*"

Section 200 of the Act of October 3, 1917, defines the term "taxable year" as meaning the 12 months ending December 31, except in case of a corporation or partnership which has fixed its own fiscal year, in which case it is defined to mean such fiscal year, and provides:

The first taxable year shall be the year ending December 31st, 1917, except that in the case of a corporation or partnership which has fixed its own fiscal year, it shall be the fiscal year ending during the calendar year 1917. If a corporation or partnership, prior to March 1st, 1918, makes a return covering its own fiscal year, and includes therein the income received during that part of the fiscal year falling within the calendar year 1916, the tax for such taxable year shall be that proportion of the tax *computed upon the net income during such full fiscal year* which the time from January 1st, 1917, to the end of such fiscal year bears to the full fiscal year; \* \* \*

The Congress in the above section of the Act expressly considered a fiscal year a portion of which fell within the year 1916, and in terms so clearly as to permit of no other construction provided that the tax imposed by that Act should be "computed upon the net income during such full fiscal year," and as clearly provided that "undivided profits earned during the taxable year" should be excluded from the invested capital used in the computation of the tax. The Bureau had, therefore, no option to compute the tax in any other manner than that which is prescribed by the statute and which was followed by it. That such a method of computation results in some instances to the disadvantage of taxpayers having a fiscal year as compared with taxpayers making returns upon the basis of a calendar year is recognized, but the evil is one which can be remedied only by the legislative branch of the Government. It can not be cured by construction of an Act so clear as to admit of no construction.

The contention of the appellant, at an oral hearing, that its case was not covered by section 200 of the Act of October 3, 1917, for the reason that it did not make its return prior to March 1, 1918, can not be conceded. Under the provision of section 13(b) of the Act of September 8, 1916, which was not amended by the Act of October 3, 1917, the returns of every corporation having a fiscal year ending within the calendar year 1917 were due prior to March 1, 1918, and it is not to be presumed that Congress intended that a taxpayer who was delinquent in filing his return or toward whom the Bureau had been lenient in this matter should be taxed upon a different basis than those who complied strictly with the letter of the statute. The language of section 200 of the Act of October 3, 1917, "makes a return," must at this time be construed to mean "was due to make a return." The Act nowhere contained any provision for computing the excess profits tax of a corporation having a fiscal year ending in 1917 upon the basis contended for by the taxpayer, and the conclusion that Congress did not intend to grant such a right in any case is strengthened by the fact that section 335(a) of the Act of February 24, 1919, contains a similar provision for computing the tax of a corporation having a fiscal year falling partly within the calendar year 1917 and partly within the calendar year 1918, but makes no reference to the time of filing the return. The Bureau has never recognized any exception to the method prescribed for computing the tax in the case of the fiscal year falling within the calendar years in which the rates of tax were different, either under the Act of 1917 or the Act of 1918, by reason of the fact that the return was filed after the due date.

It is, therefore, recommended, in the appeal of the M Company, that the action of the Income Tax Unit in assessing the excess profits tax for the fiscal year ended October 31, 1917, upon the basis of the full fiscal year, excluding from invested capital net earnings for the months of November and December, 1916, be sustained.



**Law Section 326.—Invested Capital (1918 Act—¶555, ante): (1921 Act—¶1035, post).**

**Article 851.—Intangible Property Paid in (Reg. 45—¶804, ante): (Reg. 62—¶1220, post).**

23-19-554: T. B. M. 81.

The fact that a corporation issues stock as a bonus to its three principal officers to secure their services and participation in the business is not ipso facto sufficient evidence of the existence of good will for which values can be recognized in connection with the computation of invested capital.

Such three principal officers were the principal stockholders and were active salesmen and the only salesmen employed directly by the corporation. Each was allotted certain exclusive territory in which he might employ subagents; all sales made by or through these three principal salesmen constituted the basis on which their commissions or bonuses were calculated. There were certain other sales made directly by the house which were not subject to any bonus or commission deduction. The business of the corporation appeared to be dependent almost solely upon the personal efforts of these three principal officers and stockholders. The rates of commission and the salaries for their services were properly voted.

In this case it was deemed that commission and salary aggregating 50 per cent of the gross margin on the business developed by each was not unreasonable.

1

30-19-644: O. D. 348.

Invested capital on account of intangibles bona fide paid in for stock or shares is limited to 25 per cent of stock with par value plus 25 per cent of the amount fixed in articles authorizing no par value stock as the capital with which the corporation may do business. If the laws of any State authorize issuance of true no par value stock with no amount of fixed capital such no par value stock may be taken into consideration in measuring the value of intangibles, at the fair market value as of the date or dates of issue of such stock or shares.

2

1-20-665: A. R. R. 9.

A and B, who own most of the stock of the M Company, invented certain machinery, for which patents were issued to them. The cost of obtaining these patents was paid by the company. It does not appear whether at that time the patents were formally assigned to the corporation, but, in all events, the corporation had the use of the patents as though they were its own, without compensation to the inventors. The patents at that time being undeveloped, their value was, of course, problematical, but by 1916 they had been sufficiently developed to prove of considerable value.

In 1916 the corporation desired to increase its capital, and in order to do so, the patents in question were put upon the books at a value of 2x dollars and a stock dividend was declared.

Upon the basis of the above statement of facts the Committee is clearly of the opinion that the patents were not specifically paid for by the issuance of stock, nor by any payment of cash. They were apparently treated as

though they belonged to the corporation which had paid the cost of their issuance from the time of issuance, and it is not shown that anything was paid for them at the time other than cost, nor that they had any value at that time in excess of cost. Even assuming that they were not formally assigned until 1916, it does not appear that any stock was issued in payment therefor, except such stock as was issued as a stock dividend to all stockholders, including those who had no interest in the patents, as well as to the original patentees.

The conclusion reached, therefore, is that the value of the patents as carried upon the books, 2x dollars, can not be included in invested capital, and that the decision of the Income Tax Unit must be affirmed.

3

9-20-776: A. R. R. 29

# RULING UNDER REVENUE ACT OF 1917.

Held, that the M Company can not include in its invested capital for 1917 an amount representing secret formulas paid in for stock or shares in excess of 20 per cent of the outstanding capital stock of the company on March 3, 1917.

The M Company was organized in 1909, with an authorized capital stock of 10x dollars, which was issued for—

Cash.....	x dollars
Secret formulas.....	9x dollars

On July 1, 1917, the company issued additional stock of the par value of 90x dollars for—

Cash.....	5x dollars
Capitalization of good will.....	40x dollars
Appreciation in value of secret formulas.....	45x dollars

The record in the case does not show whether this increase of 90x dollars in capital stock was made through the appreciation of assets and the declaration of a stock dividend, but it appears that this method of increasing capital stock has been used. The appreciation in the value of the processes was largely due to the further development of the formulas. The cost of this development was paid by the company and deducted as business expenses.

In the computation of changes in invested capital, Schedule D, Form 1103, for the year 1917, the company eliminated the item of 40x dollars on account of good will, but claimed that the balance of 50x dollars should be prorated for six months and 25x dollars admitted as an addition to invested capital. The return was prepared on that basis.

An examination of the return for 1917 shows that the company sustained a loss for 1911 and made profits in 1912 and 1913 and that the 90x dollars increase in capital stock was made as of July 1, 1917, and distributed pro rata to the various stockholders on the basis of their respective stockholdings, thus indicating that the increase in capital stock was made through the distribution of a stock dividend.

In the audit of the return for 1917 the Income Tax Unit rejected the claim for addition to invested capital in the amount of 25x dollars and allowed the prorated amount of 5x dollars cash paid in July 1, 1917. The Unit also allowed 20 per cent of the capital stock outstanding on March 3, 1917, as representing the secret formulas.

In the presentation of the case, it was strongly argued that the secret formulas are tangible property; that the Unit was in error in disallowing 7x dollars of the capital account in order to conform with the limitation prescribed by the statute and that the total amount of 25x dollars should have



been allowed to stand for the reason that the secret formulas had a value greatly in excess of the value used when they were turned in to the company for stock at the time of its organization. The value can not be fixed for the secret processes at the time they were paid in for stock; neither can the cost of development be established. The company urges that since A, a stockholder, was able to sell  $x$  dollars of stock at par the  $9x$  dollars retained by him was worth par, thus establishing the value of the processes at the time they were paid in for stock. It should be noted a great deal of stress is laid upon the value of the processes.

It is claimed further that the increase in value of secret processes, is due to the fact that they had previously been carried at a low valuation on the books, and that the earnings of the company depend to a very large degree on these secret processes and formulas, which are being constantly improved year after year for the benefit of the business. It was deemed, therefore, only fair that such processes be carried at a value which more truly represents their earning power, as compared with the other tangible assets of the business.

While it is not so stated, it would indicate that a stock dividend was declared against the appreciated assets of the company. The conference had with the attorneys tends to substantiate this view. If this be true, then the principle that the distribution of a stock dividend does not increase nor decrease invested capital would be applicable.

The question as to whether or not the secret formulas can be considered as tangible property is presented. Section 207 of the Revenue Act of 1917 provides in part as follows:

\* \* \* the good will, trade-marks, trade brands, the franchise of a corporation or partnership, or other intangible property, shall be included as invested capital if the corporation or partnership made payment bona fide therefore specifically as such in cash or tangible property, the value of such good will, trade-mark, trade brand, franchise, or intangible property, not to exceed the actual cash or actual cash value of the tangible property paid therefor at the time of such payment; but good will, trade-marks, trade brands, franchise of a corporation or partnership, or other intangible property, bona fide purchased, prior to March third, nineteen hundred and seventeen, for and with interest or shares in a partnership or for and with shares in the capital stock of a corporation (issued prior to March third, nineteen hundred and seventeen), in an amount not to exceed, on March third, nineteen hundred and seventeen, twenty per centum of the total interests or shares in the partnership or of the total shares of the capital stock of the corporation, shall be included in invested capital at a value not to exceed the actual cash value at the time of such purchase, and in case of issue of stock therefor not to exceed the par value of such stock.

Article 47 of Regulations 41 provides:

The term "other intangible property" as used in section 207 will be construed to mean property of a character similar to good will, trade-marks, and the other specific kinds of property enumerated in the same clause. \* \* \*

Articles 57 and 58 of Regulations 41 provide respectively as follows:

If good will, trade-marks, trade brands, franchises of a corporation or partnership, or other intangible property has been purchased with stock of shares issued prior to March 3, 1917, the amount that may be included in invested capital must not exceed (a) 20 per cent of the par value of the total stock or shares outstanding on that date, nor (b) the actual value of the asset at the date acquired, not (c) the par value of the stock issued in payment for the asset.

The 20 per cent limitation upon intangible property purchased prior to March 3, 1917, for or with stock or shares of the corporation or partnership, applies not to each item or class of intangible property separately, but to the aggregate amount of all such property so purchased. Such intangible property may be included in the invested capital only up to an amount not exceeding 20 per cent of the total stock or shares of the corporation or partnership on March 3, 1917, even though the aggregate amount of such intangible property be greater in value than such 20 per cent of the par value of the total stock or shares.

Intangible property bona fide purchased prior to March 3, 1917, with stock having no par value may be included in invested capital at a value not exceeding the actual cash

value of such intangible property at the time of the purchase and in an amount not exceeding 20 per cent of the total shares of stock outstanding on March 3, 1917, measured by their value as at the date or dates of issue.

The Advisory Tax Board in Memorandum 5 (Cumulative Bulletin, December, 1919, page 286), recommended that Ruling 24 issued by the Tax Reviewers, interpreting article 58 quoted above, be amended to read as follows:

*Twenty Per Cent Limitation upon Intangible Property in Cases where Capital Stock has been Increased or Reduced.*—Where since the organization of a corporation its capital stock has been increased or reduced and such change represents an actual acquisition of new property for stock or an actual impairment of original properties, the 20 per cent limitation imposed by section 207 will be based upon the par value of the total stock outstanding on March 3, 1917.

It appears to the Committee that the value of the formulas at the time the company was organized was apparently largely speculative and any increase in value through subsequent development could not properly be included by way of an addition to invested capital.

After consideration of all the facts presented on the questions at issue and the definition of the term "intangible property" as used in the Revenue Act of 1918, the Committee has reached the conclusion that the secret formulas cannot be considered tangible property, and that additions to invested capital in 1917 through revaluation of the intangible assets cannot be permitted under the law and the regulations. Therefore, it is recommended that the decision of the Unit be confirmed.

4

25-21-1698: A. R. M. 131.

Held, that intangible property, when acquired for tangible property, must be taken into account at the value of such intangible property at date of acquisition, and that in the case of the M Company such value is measured by the then fair market value of the tangible property exchanged therefor and not by the original cost of such tangible property. It is assumed the fair market value of the lands at time of transfer will be satisfactorily established by the taxpayer.

The Income Tax Unit has submitted the following issue for an expression of opinion by this Committee:

Whether intangibles can be included in invested capital at a value representing the prevailing market value (as at the date of transfer) of tangible property given in exchange for intangible property, or whether the company transferring tangible for intangible property is limited to the cost value of tangible property so transferred.

The facts on which the issue is based are expressed by the Unit in the following language:

The taxpayer, the M Company, purchased a large tract of land about the year 188—upon which it proposed to establish and operate a certain business. It was absolutely essential to successful operation that business houses of a certain character be established and operated. Therefore the M Company made certain offers and inducements to large owners of such houses to locate on their premises. Contracts were made from time to time with nearly all of these large owners of such business houses who pursuant to their contracts established and operated plants.

The M Company agreed among other things to deed to these owners a portion of its lands. The consideration received by the M Company was in the form of an intangible asset, namely, the trade or business that would result to the M Company by the location of these large plants on their large tract of land above mentioned.

The point at issue is whether the intangibles may be included in invested capital at a value measured by the original cost of the land or the market value of the land at time of transfer.

The issue first of all involves the question of income resulting from the exchange of property for property. Manifestly there was a conversion of



one asset, land, into another form of asset which had an intangible value. Article 1563 of Regulations 45 provides that:

Gain or loss arising from the acquisition and subsequent disposition of property is realized when as the result of a transaction between the owner and another person the property is converted into cash or into property (a) that is essentially different from the property disposed of and (b) that has a market value.

In the instant case the intangible has a value measured by the consideration paid therefor, viz., tangible property. It is not the cost of this tangible property which measures the value of this intangible asset, but its real market value as of date of transfer. When the value of the intangible asset is so determined the difference between such value and the original cost of the land exchanged therefor is the amount of profit realized in the conversion of the land into another form of asset. Nor does such a transaction involve the question of appreciation because it is not the value of the land itself which is written up on the books of the corporation but the value of an intangible asset measured by the consideration paid therefor. An exchange of this land for cash equivalent to the present market value of the land would have determined a profit over the original cost. This profit would have been reflected in the surplus of the company. In a similar manner the excess of the value of the intangible acquired over the cost of the land given in exchange therefor is a proper credit to the surplus of the corporation. The determination of a current value in the instant case has no relation to original cost because it must be assumed that the land before and after transfer had an immediate realizable value.

The Committee is accordingly of the opinion that intangible property, when acquired for tangible property, must be taken into account at the value of such intangible property at date of acquisition, and that in the instant case such value is measured by the then fair market value of the tangible property exchanged therefor and not by the original cost of such tangible property. It is assumed the fair market value of the lands at time of transfer will be satisfactorily established by the taxpayer.

5

44-21-1893: A. R. R. 520.

#### REVENUE ACT OF 1917.

Recommended in the appeal of the M Company that there be allowed as a deduction from gross income in the company's 1917 return a depreciation of patent rights in an amount which bears the same ratio to the established cost of the patent rights as 12 months (the taxable year) bears to 23.5 months (the total period for which the patent rights are to run); and that the valuation assigned to such asset as of January 1, 1917, for invested capital purposes be the cost of the asset,  $x$  dollars, minus depreciation for one and one-half months, or an amount not in excess of 20 per cent of the total shares of stock outstanding on March 3, 1917, measured by their value as at date or dates of issue, whichever is lower. (See art. 58, Reg. 41.)

The Committee has had under consideration the appeal of the M Company from the action of the Unit in making certain adjustments respecting the valuation of patent rights for the purpose of computing invested capital and respecting the basis of computing allowances for depreciation of such rights.

The records in the case indicate that patent rights were acquired November —, 1916, extending to November —, 1918 (a period of 23.5 months), by the taxpayer for a consideration of  $x$  dollars cash value of the corporation's capital stock. On April —, 1917, a new right, to begin November —, 1918, and extend for a period of eight years was secured. It is shown

that the new right extending for the additional period of eight years was given to the corporation gratis. Notwithstanding the receipt of the new right which became effective November —, 1918, the corporation continued during the year 1917 to use and operate under the first right acquired as aforesaid.

In the brief submitted by the taxpayer's counsel the following matter is set forth with respect to the treatment accorded this asset (patent right) in the preparation of income and excess profits tax return for the calendar year 1917:

In making its income tax return the corporation considered claiming "depreciation" on patent rights at the rate of 12/23.5 per year during the entire year 1917 at which rate in fact its original investment should be amortized, but in a spirit of willingness to stand its fair share of war taxation it conceived that it would take such "depreciation" only up to April —, 1917, when the new right was received and thereafter "depreciate" on the basis that at least the original value of the patent right, viz.,  $x$  dollars had been restored and "depreciation" should thereafter be claimed upon the basis of a life from April —, 1917, to November —, 1926.

With reference to the so-called "appreciation of patents" the corporation simply conceived that the gift of April —, 1917, restored the original value and treated the gift as "paid-in surplus" of the value theretofore lost by "depreciation" for five months from November —, 1916, at the rate of 1/23.5 of cost per month. This sum averaged over the year made an invested capital increase of  $1/6x$  dollars which was claimed and used as an element in computing invested capital.

In the audit of the return the Income Tax Unit insisted that depreciation should be on the basis of the original cost of  $x$  dollars spread over a ten-year life, embracing the two separate periods for which rights were granted, November —, 1916, to November —, 1926, and accordingly disallowed all depreciation claimed in excess of amounts determined on that basis.

The Unit also eliminated from invested capital such depreciation as had been claimed by the taxpayer from November —, 1916, to April —, 1917, and which was sought to be restored to the value of the asset for the purpose of subsequent depreciation allowances.

The taxpayer contends that the method adopted by it in treating this asset in the manner heretofore outlined in the preparation of its income tax return for 1917 was both equitable and correct under the law and regulations. Action contrary to this contention has been taken by the Unit in adjusting the corporation's tax liability, and it is from such action that the taxpayer appeals.

In the opinion of the Committee, both the taxpayer and the Unit have erred in this matter. It is evident from the foregoing statements that the taxpayer acquired on November —, 1916, an intangible asset (patent right) to extend to November —, 1918, a period of approximately 23.5 months, and that such asset was acquired for a consideration of  $x$  dollars cash value of the company's capital stock at that date. The record indicates with respect to the stock issue of the corporation that it consisted of  $y$  shares of no par value.

Article 58 of Regulations 41, pertaining to the valuation for invested capital purposes of intangible property, provides in part:

Intangible property bona fide purchased prior to March 3, 1917, with stock having no par value may be included in invested capital at a value not exceeding the actual cash value of such intangible property at the time of the purchase and in an amount not exceeding twenty per cent of the total shares of stock outstanding on March 3, 1917, measured by their value as at the date or dates of issue.

There is nothing in the record which indicates the method by which a valuation of  $x$  dollars has been fixed and accepted by the Unit, but for the purpose of rendering an opinion upon the point at issue, the Committee



assumes that such value has been determined in accordance with the law and regulations and to the satisfaction of the Unit.

Article 163 of Regulations 45, issued under the Revenue Act of 1918, is equally applicable under the Revenue Act of 1917. This article provides in part:

If, however, an intangible asset acquired through capital outlay is known from experience to be of value in the business for only a limited period, the length of which can be estimated from experience with reasonable certainty, such intangible asset may be the subject of a depreciation allowance, \* \* \*.

In the determination of the depreciation allowance which may be claimed in the 1917 return of the taxpayer, two factors must be known and are apparent in the record, to wit: the cost of the asset, and its life, as determined by the period for which the right under which the company operated in 1917, was to run.

These factors as shown by the record are: cost of asset,  $x$  dollars; and life of asset, 23.5 months.

It is the opinion of the Committee, therefore, that the depreciation allowance to which the taxpayer is entitled for the calendar year 1917 is an amount which bears the same ratio to  $x$  dollars as twelve months (the taxable year) bears to 23.5 months (the total period or life of the asset).

In line with this opinion there appears to be no question as to the measure of value which may be assigned to the asset (patent right) for purposes of invested capital as of January 1, 1917, which necessarily must be  $x$  dollars minus depreciation for one and one-half months (November —, to December 31, 1916), or an amount not in excess of 20 per cent of the total shares of stock outstanding on March 3, 1917, measured by their value as at date or dates of issue, whichever is lower.

It is recommended, therefore, in the appeal of the M Company that there be allowed as a deduction from gross income in the company's 1917 return a depreciation of patent rights in an amount which bears the same ratio to the established cost of the patent rights,  $x$  dollars, as 12 months (the taxable year) bears to 23.5 months (the total period for which the patent rights are to run); and that the valuation assigned to such asset as of January 1, 1917, for invested capital purposes be the cost of the asset,  $x$  dollars minus depreciation for one and one-half months, or an amount not in excess of 20 per cent of the total shares of stock outstanding on March 3, 1917, measured by their value as at date or dates of issue, whichever is lower. (See art. 58, Reg. 41.)

6

Revenue Act of 1917 and 1918.

Revenue Acts of 1917 and 1918.

The amount of stock issued for intangible property and the subsequent revaluation of such property can not be accepted as proof of the value of the intangibles at date of acquisition.

Earnings of a taxpayer subsequent to the acquisition of intangible property, unsupported by other acceptable proof, can not be adopted as a basis for valuing such property as of the date acquired.

The Committee has had under consideration the appeal of the M Company from the action of the Income Tax Unit in disallowing in the computation of the appellant's statutory capital for 1917, 1918, and 1919 (1) good will, patents and secret processes, valued by the taxpayer at  $10x$  dollars; and (2) accrued dividends in the amount of  $.79x$  dollars for 1918 and  $1.11x$  dollars for 1919.

Supplementary Bulletin Rulings.

The taxpayer was incorporated January —, 1914, under the laws of the State of S. It then acquired from the N Company all the assets, tangible and intangible, of a subsidiary of that company used in connection with the manufacture and sale of certain articles. Preferred stock in the amount of  $1.5x$  dollars was issued for the tangible assets, and common stock of  $40x$  dollars for the intangibles. The evidence presented upon appeal, as supplemented in much detail orally, shows that the N Company, by virtue of experimentation extending over approximately 17 years prior to 1914, had perfected processes, developed secret formulae, obtained patents, and made application for other patents, all of which enabled it as at the end of 1913 to manufacture an article which the taxpayer contends had a useful life practically double that of any similar article then in the market; that several of the processes and inventions which had been perfected by the N Company but not patented were subsequently patented by the appellant; and that the intangibles acquired constituted the foundation for the success of the business, which began during 1917. The earnings of the predecessor owner of the intangibles are not available to enable the claimed value of these assets to be checked in accordance with A. R. M. 34 (C. B. 2, p. 31). At a meeting of the board of directors of the appellant held on December —, 1917, the officers of the corporation appear to have concluded that the intangibles, acquired for  $40x$  dollars common stock, had in fact turned out to be worth less than that amount and the valuation was thereupon reduced to  $10x$  dollars, made up as follows: Good will,  $x$  dollars; research records and scientific data,  $1.9x$  dollars; patents and patent applications,  $7.1x$  dollars; and the outstanding common stock was correspondingly reduced.

Aside from the common stock claimed to have been issued for the intangibles in question and the subsequent action of the board of directors with respect to this property, the only evidence of record purporting to substantiate the value claimed for the intangibles at the time acquired by the corporation is the earnings of the company for the years 1917 to 1921, inclusive. The amount of stock issued for the intangible property and the action of the board of directors on December —, 1917, can not be accepted as proof of the value claimed, and the Committee has repeatedly ruled that earnings of a taxpayer subsequent to the acquisition of intangible property, unsupported by other acceptable proof, can not be adopted as a basis for valuing such property as of the date acquired.

The so-called accrued dividends of  $.79x$  dollars for 1918 and  $1.11x$  dollars for 1919 are shown not to have been paid, declared, or authorized, and were merely set aside as a book entry to record the amount of dividends accumulated on the preferred stock, and the Unit has properly conceded the contention of the taxpayer that the amounts involved should be included in the statutory capital for the years in question.

The Committee accordingly recommends that the action of the Income Tax Unit in excluding from statutory capital for 1917 to 1919, inclusive, the claimed value of intangibles be sustained; that the so-called accrued dividends for 1918 and 1919 be included in the computation of the statutory capital for those years; and that the appeal be sustained in part and denied in part.

KINGMAN BREWSTER,

*Chairman Committee on Appeals and Review.*



**Law Section 326.—Invested Capital** (1918 Act—¶555, ante): (1921 Act—¶1035, post).

**Article 852.—Percentage of Inadmissible Assets** (Reg. 45—¶805, ante): (Reg. 62—¶1221, post).

1-19-125: O. D. 86.

Since the income derived from Porto Rico bonds is not subject to tax, the bonds are inadmissible assets and can not, therefore, be included in invested capital.

1

II ('23)-26-1122: I. T. 1796.

### **Revenue Act of 1917.**

There is nothing in the Revenue Act of 1917 or in Regulations 41 which permits inadmissible assets purchased out of earnings for a taxable year to be considered in computing invested capital. That method of treating inadmissibles was first introduced by section 326 (c) of the Revenue Act of 1918, and was carried forward into section 326 (c) of the Revenue Act of 1921, but it is not authorized by the Revenue Act of 1917. There may be cases where changes in the amount of inadmissibles held during 1917 will cause an adjustment in invested capital for that year, but a case of that sort never arises out of an increase in inadmissible assets through an expenditure of current earnings.

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Law Section 326.—Invested Capital (1918 Act—¶555, ante): (1921 Act—¶1035, post)

Article 853.—Changes in invested capital during year (Reg. 45—¶806, ante): (Reg. 62—¶1222, post).

27-21-1720: O. D. 969.

Inasmuch as trustees in liquidation are required to file a corporate return of annual net income and excess profits for the entire taxable year, including therein the gross income received by the corporation prior to their appointment and also the gross income received under their supervision, the invested capital should be computed in the same manner as in the case of an active corporation, making due allowance for any amount of capital assets which have been liquidated and returned to the stockholders during that year.

However, if, owing to abnormal circumstances affecting the capital or income of the corporation, the tax computed in the usual manner works upon the corporation an exceptional hardship, evidenced by gross disproportion between the tax so computed and the tax computed by reference to representative corporations specified in section 328 of the Revenue Act of 1918, the taxpayer may file a claim for special assessment in accordance with sections 327 and 328 of the Act.





Law Section 326.—Invested Capital (1918 Act—¶555, ante): (1921 Act—¶1035, post).

Article 854.—Computation of Average Invested Capital (Reg. 45—¶807, ante): (Reg. 62—¶1223, post).

8-21-1473: O. D. 822.

Inasmuch as 1920 was a leap year, adjustments of invested capital under schedule H, page 2 of Form 1120 for 1920, should be made on the basis of a year of 366 days.

1

I ('22)-30-433: A. R. R. 979.

### Revenue Acts of 1917 and 1918.

Recommended, in the appeal of the M Company, that in the absence of evidence of error the rates of depreciation used by the Unit in computing allowable depreciation deductions in 1917 and 1918 be approved; that the action of the Unit in considering this company's prewar period as covering all of the prewar years, and in excluding from invested capital paid-in surplus with respect to intangible assets acquired at date of reorganization in 1916, be sustained; and that because of the exclusion of such intangible assets it be recognized that an abnormality exists in this company's invested capital which entitles it to special assessment for both 1917 and 1918, and that assessment be made on the basis of comparatives carefully selected, provided any relief is afforded thereby.

The Committee has had under consideration the appeal of the M Company from the action of the Income Tax Unit in adjusting its returns for 1917 and 1918, and, on the basis of such adjustments, assessing additional taxes for each year.

Following an audit of this company's books in December, 1919, by a revenue agent, the Unit in March, 1920, notified the company that additional taxes amounting to 8x dollars for 1917 and 28x dollars for 1918 were proposed. The taxpayer immediately protested the assessment of these taxes, and after considerable correspondence and an oral hearing before the Unit, the letter of March, 1920, was modified by a revised letter dated September, 1920, in which the proposed assessments were reduced to 4x dollars for 1917 and 12x dollars for 1918, and these amounts were assessed. The company has appealed to this Committee on three points, as follows:

1. The rates of depreciation used by the Unit.
  2. The deduction allowable under section 203 of the Revenue Act of 1917 and the war-profits credit provided by section 311 of the Revenue Act of 1918.
  3. The exclusion of intangible assets alleged to have been acquired for stock at date of reorganization in 1916.
1. In the computation of the allowable deductions for depreciation the Unit used the same rates as the company had used in its original returns, the total allowance being less due to the fact that the company applied the rates to the total asset values at the close of the year while the Unit averaged the assets by taking the sum of the amounts shown on the opening and closing balance sheets and dividing this by two. The company now concedes the correctness of the Unit's procedure, but contends that the rates originally used and allowed by the Unit were too low to cover the depreciation actually sustained, while the Unit states that it has no objection to allowing the full

amount of depreciation actually sustained but believes that the evidence submitted did not substantiate a greater amount than that allowed. The Committee accordingly requested the appellant's representatives, at a recent oral hearing accorded to them, to submit depreciation schedules for all years from 1912, the year in which the manufacture of its leading line was commenced, showing the company's past experience relative to normal depreciation and reasons for claiming accelerated rates in 1917 and 1918. In response to this request the Committee has received a revised depreciation schedule for the years 1917 and 1918 only, which, as to asset values, is identical with the schedule prepared by the Unit, the only difference being that higher rates are claimed. Relative to the company's past experience under normal conditions the following statement is made:

This company acquired its original assets in 1916. Its predecessor's records do not disclose sufficient data from which to ascertain depreciation actually accrued under normal working conditions on buildings and machinery used in manufacturing.

This appears to be a rather unusual condition, inasmuch as these same books, according to the appellant's contention relative to invested capital adjustments, show to the fraction of 1 per cent the actual assets employed in the manufacture of the product and the exact income received from that branch of the business.

The Committee is of the opinion that the rates allowed by the Unit are fair, and in the absence of evidence to show that the use of such rates does not provide for depreciation actually sustained, recommends that these rates be approved.

2. The appellant was organized in December, 1916, and took over the assets and business of the N Company. The predecessor of the N Company was the O Company, a corporation whose only business was manufacturing another product. In February, 1912, the charter of the last-named company was amended changing its name to the N Company and authorizing it to change its business. The old business was not finally closed out until subsequent to the close of the year 1913. Thus, during the year 1911, the predecessor of the present corporation was in the business of manufacturing one product and during the years 1912 and 1913 in that of manufacturing two products, in consequence of which the appellant contends that it had only one full prewar year, 1913, inasmuch as the business of manufacturing its present product, its business during the taxable years, is substantially a continuation only of that part of the business conducted during the whole of one prewar year. It has submitted a profit and loss account for the year 1913 which purports to show the allocation of all items of gross income and expenses as between the two kinds of business, a balance sheet as at December 31, 1912, showing similar allocation of all assets and liabilities, and contends that the deduction for 1917 and the war profits credit for 1918 should be computed on the basis of the income and invested capital attributable to the present business only in 1913. In passing it may be stated that a cursory examination of the statements submitted shows them to be nothing more than arbitrary estimates and they could be nothing else unless the system of accounting employed was on a very elaborate scale. The taxpayer's statement quoted above relative to depreciation does not indicate the use of such a system.

Section 201 of the Revenue Act of 1917 provides that "For the purpose of this title"—that is, Title II, war excess-profits tax, and this also includes the deduction provided by section 203—"every corporation or partnership not exempt under the provisions of this section shall be deemed to be en-



gaged in business, and all the trades and businesses in which it is engaged shall be treated as a single trade or business, and all its income from whatever source derived shall be deemed to be received from such trade or business."

No exactly similar provision exists in the 1918 Act, but one of the provisions for the war-profits credit is based on the net income and invested capital of the prewar period if the corporation *was in existence* during such period or a part thereof.

Section 320(b) provides:

The average net income for the prewar period shall be determined by dividing the number of years within that period during the whole of which the corporation *was in existence* \* \* \*.

Section 326 provides:

The average invested capital for the prewar period shall be determined by dividing the number of years within that period during the whole of which the corporation *was in existence* \* \* \*.

Section 330 provides:

That in the case of the reorganization, consolidation, or change of ownership after January 1, 1911, of a trade or business now carried on by a corporation, the corporation shall for purposes of this title be deemed to *have been in existence* prior to that date, and the net income and invested capital of such predecessor trade or business for all or any part of the prewar period prior to the organization of the corporation now carrying on such trade or business shall be deemed to have been the net income and invested capital of such corporation.

Assuming that it could be done, the Committee knows of no provision of the law which provides that in determining the war-profits credit under the 1918 Act, income and invested capital attributable to certain abandoned branches or departments of a business conducted during the prewar period be segregated and eliminated from prewar data, and in the present case the Committee can not concede that this could be done even with approximate accuracy.

In view of the foregoing, it is recommended that the action of the Unit in considering all of the years 1911, 1912, and 1913 as this company's prewar period be sustained.

3. It appears to be unnecessary to discuss at length the third contention raised by the appellant, for the reason that if it were conceded it would in effect be allowing indirectly a paid-in surplus for intangibles, and this Committee has repeatedly and consistently held that no paid-in surplus can be allowed either directly or indirectly with respect to intangible assets acquired.

Briefly the facts are: The M Company was incorporated in December, 1916, and acquired the assets and business of the N Company for 80x dollars common stock and 20x dollars preferred stock and the assumption by the former of liabilities of the latter amounting to 22.3x dollars. The tangible assets acquired were appraised by an appraisal company at 127.5x dollars. After deducting the liabilities assumed, 22.3x dollars, the net value of tangibles was 105.2x dollars, for which stock of the par value of 100x dollars was issued, resulting in a paid-in surplus of 5.2x dollars. The Unit has allowed this latter amount. The company contends that inasmuch as it acquired a mixed aggregate of tangible and intangible property it is entitled to have an allocation made of the stock issued so as to apply a fair proportion thereof against the intangible property acquired, which amount should be included in invested capital subject to the limitations prescribed by law, and a like fair proportion to tangible property which would result in a paid-in surplus with

respect to such tangible property equal to the difference between the actual value thereof and the par value of the stock fairly allocated thereto.

The Committee can not concede this contention, and in line with its uniform practice heretofore must recommend that the action of the Unit on this point be sustained.

The company contends, and the evidence in the file abundantly supports the contention, that at date of reorganization in 1916 it acquired very valuable intangible assets. There seems to be no question, therefore, that the necessary exclusion of these assets from invested capital created an abnormality therein which justifies special assessment. The excess profits tax assessed for 1917 amounts to — per cent plus of net income and the war and excess-profits taxes for 1918 amounts to — per cent plus of net income. The Committee accordingly recommends that proper comparatives be carefully selected for both 1917 and 1918, with a view to giving effect to the intangible assets excluded in the computation of this company's invested capital and that assessment of taxes be made on the basis of such comparatives, provided any relief is afforded thereby.

Summing up: It is recommended, in the appeal of the M Company, that in the absence of evidence of error the rates of depreciation used by the Unit in computing allowable depreciation deductions in 1917 and 1918 be approved; that the action of the Unit in considering this company's prewar period as covering all of the prewar years, and in excluding from invested capital paid-in surplus with respect to intangible assets acquired at date of reorganization in 1916, be sustained; and that because of the exclusion of such intangible assets it be recognized that an abnormality exists in this company's invested capital which entitles it to special assessment for both 1917 and 1918 and that assessment be made on the basis of comparatives carefully selected, provided any relief is thereby afforded.



Law Section 326.—Invested Capital (1918 Act—¶555, ante): (1921 Act—¶1035, post).

Article 855.—Invested Capital for Full Year or Less (Reg. 45—¶808, ante): (Reg. 62—¶1224, post).

15-19-449: O. D. 255.

A telephone company should make a 1918 return for its accounting period, either calendar or fiscal year, and all income applicable to such period should be included in the corporation's return irrespective of the portion of the year during which it may have been operated under Government control. The invested capital should be computed on the basis of a 12 months' period and not prorated.





Law Section 326.—Invested Capital (1918 Act—¶555, ante): (1921 Act—¶1035, post).

Article 857.—Method of Determining Available Net Income (Reg. 45—¶810, ante): (Reg. 62—¶1226, post).

1-19-124: O. D. 85.

The entire amount of Federal income, war profits, and excess profits taxes accrued for the taxable year remains a part of invested capital for the succeeding year (since it is not deductible from gross income in returns) until the taxes become due in the succeeding year. Accrual of taxes for the taxable year does not affect invested capital for the taxable year, except to the extent that the accrual of such taxes will cause dividend payments to draw on surplus as at the beginning of the year.

1

18-19-191: T. B. R. 54

Memorandum accounts of estimated earnings not considered sufficiently definite to be used instead of the average monthly earnings in computing invested capital under article 857, Regulations 45.

In the case of the M Company three points are presented for consideration and decision: (1) Whether an accrual of taxes for the months of January, February, and March of 1917 is properly used in computing the invested capital for the year 1917: (2) whether, assuming that the bureau was warranted in taking accrued taxes for those months into consideration, was it not in error in using the monthly earnings instead of the average earnings for the year; and (3) whether any computation can reduce the capital below the actual paid-in capital of the corporation.

The situation presented was brought about in the following manner: The corporation apparently had earnings of 11x dollars for the months of January, February, and March, 1917. During the month of March it declared and paid a dividend of 10x dollars, which amount, taken in connection with the accrual of taxes on the earnings for the first three months of 1917, exceeds the amount of earnings for that period and the balance was construed to have been paid out of accumulated surplus and capital of the corporation at the close of the year 1916 (Incidentally it may be mentioned that the corporation was placed in the position of distributing surplus and capital because at the time of the payment of the dividend there were apparently sufficient earnings to pay the dividend and also to take care of the taxes under the laws then enacted.)

The argument of the corporation relative to the first point is that to use the accrual of taxes in the manner stated is to create a situation in which dividends which were actually paid out of current earnings are made to appear to be practically paid out of surplus and undivided profits, thus working a hardship which the law does not seem to impose. It is presented that the accrued taxes were not paid and were not required to be paid until more than one year after the declaration of the dividend. This point may be disposed of by reference to article 857, Regulations 45, which authorizes the method used for determining the aggregate amount of earnings of the taxable year available for all purposes on any given date. The grounds upon which this article rests have been thoroughly re-examined in connection with this case, and no sufficient reason to change the established ruling has been found.

The other two points are disposed of by the disposition of the second point at issue, as a settlement on the basis recommended will raise the

invested capital above the actual paid-in capital and thus dispose of point three.

The second point presented by the corporation is that, assuming that the bureau was warranted in taking accrued taxes into consideration, it was in error in using the monthly earnings instead of the average earnings for the year. Article 857, Regulations 45, provides in substance that average earnings shall be used "unless the corporation shows from its books or other records that a greater proportion of its earnings for the year was available on such date." The agreed statement as to this is that the corporation did not close its books each month, but that it made a fairly accurate memorandum estimate of the earnings of each month for the use of the officers of the corporation. This estimate was not carried into the balance sheet of the corporation, but is asserted to be simply a memorandum for use as above stated. The examining officer, however, accepted this memorandum as a sufficient record of the earnings of the corporation for the three months in question, which estimate was less than the average for those three months would show. But the corporation does not close its books at the end of each month, and the memorandum in question was an informal approximation, insufficient to overthrow the general presumption in favor of the average or prorating method, which in this and many other similar situations under the law has frequently been applied against the desire of the taxpayer. It is recommended, therefore, that the tax liability be computed on the basis of average monthly earnings instead of the figures shown by the memorandum.

2

31-20-1110: O. D. 619.

In the last sentence of article 857, Regulations 45, it is recognized that in some cases the computation of the amount of net income available for distribution as dividends will be indeterminate. This will be true in any case in which the amount distributed as a dividend exceed the earnings of the taxable year to the date of the dividend payment plus the accrued Federal income and profits taxes on such earnings.

The computation under such conditions is shown in the following illustration:

Capital stock, Jan. 1, 1919.....	\$400,000.00
Surplus, Jan. 1, 1919.....	100,000.00
Invested capital, Jan. 1, 1919.....	500,000.00
Total earnings for 1919.....	120,000.00
Dividend paid Apr. 1, 1919.....	40,000.00
Proportionate part of earnings to Apr. 1, 1919.....	30,000.00
Income and profits taxes accrued to Apr. 1, 1919, as computed below.....	7,315.00
8 per cent of invested capital.....	40,000.00
Specific exemption.....	3,000.00
Excess profits credit.....	43,000.00
Proportionate part of credit to Apr. 1, 1919.....	10,750.00
20 per cent of invested capital.....	100,000.00
Proportionate part of \$100,000 to Apr. 1, 1919.....	25,000.00
Tax under bracket 1, 20 per cent of \$25,000—\$10,750 (\$14,250).....	2,850.00
Tax under bracket 2, 40 per cent of \$5,000.....	2,000.00



Accrued excess profits tax.....	4,850.00
Net income to April 1, 1919.....	30,000.00
Excess profits tax.....	\$4,850
Proportionate part of specific exemption.....	500
	<hr/> 5,350.00
Subject to income tax at 10 per cent.....	24,650.00
Accrued income tax.....	2,465.00
Accrued profits tax.....	4,850.00
	<hr/> 7,315.00
Total accrued income and profits tax.....	7,315.00
Income to Apr. 1, 1919.....	30,000.00
Reduced by taxes to Apr. 1, 1919.....	7,315.00
	<hr/> 22,685.00
Amount net income available for dividends.....	22,685.00
Amount of dividend.....	40,000.00
Amount of income available.....	22,685.00
	<hr/> 17,315.00
Amount chargeable against surplus.....	17,315.00

The adjustment on account of this amount (\$17,315.00) averaged from April 1, 1919, to the end of the year must be made in Schedule H of Form 1120.

3

30-21-1749: O. D. 982.

In accordance with the principle set out in article 857 of Regulations 45, dividends are deemed to be paid from true earned surplus. In carrying the earnings for a proportionate part of the year to surplus account for the purpose of declaring a dividend, the earnings so carried should represent the earnings of the current year less accrued expenses. Where the true earned surplus of the current year proportioned to the date of dividend payment is not sufficient to cover such payment, the true earnings included in the surplus account as of the beginning of the taxable year will be deemed to cover such payment.

This does not conflict with the principle embodied in article 845 of the regulations. It is in accord with the accounting principle that where accounts are kept on the accrual basis, expenses of a year should be charged against the income of that year. In order, therefore, to apply this principle, taxes of the current year should be charged against the income of that year, and only that proportion of the income of the current year is available for dividends which is in excess of taxes and other proper charges against such income.

4

I('22)-29-416: I. T. 1396.

#### Revenue Act of 1918.

In computing, under the provisions of article 857, the amount of earnings available for the payment of dividends, all income for the taxable year over and above expenses, taxes, and other accrued liabilities of such year, regardless of whether or not any part of such income is exempt from Federal income tax, should be considered.

In making such computation donations previously paid must be deducted.

5

II('23)-3-773: I. T. 1602.

**Revenue Act of 1921.**

In October, 1921, the M Company distributed a cash dividend to its stockholders, such distribution being in excess of the available surplus, undivided profits, and earnings. It was the express purpose of the company when the distribution was made that all or any portion of the amount distributed in excess of the available surplus, undivided profits, and earnings would be chargeable to depletion reserve as a return of capital. The company determines in each year as of September 30 the rates of depletion and depreciation for the current year, and book entries in accordance with such determination are made as of December 31 of each year.

The question is raised whether the charges determined as of September 30, providing for depreciation and depletion for 1921, should be allocated proportionately to each month beginning with January, 1921, and become a charge against the surplus, undivided profits, and earnings available as of the close of each such month, even though the entries for depletion and depreciation were not actually determined and booked until December, 1921, subsequent to the declaration of payment of the distribution above referred to.

It is held, that the net income for the year 1921, determined after providing for depreciation and depletion and also for an accrual of income and excess profits taxes for the year, should be prorated over the year from January 1, 1921, to the date of the payment of the dividend made in October, 1921, in order to determine the amount available for distribution to the stockholders. Any excess of the dividend over the amount of surplus from previous years and of current earnings is a return of capital in a corresponding amount.

6

II('23)-16-1003; A. R. R. 2839

**Revenue Act of 1918.**

Article 857 is construed to mean that if the books of a corporation do not show the amount of earnings or profits on a dividend date, and the corporation actually closed its books on June 30 and December 31 of each year, the earnings or profits for the accounting period January 1 to June 30 should be deemed to have accumulated ratably in the case of a dividend declared in May.

The Committee has had under consideration the appeal of the M Company from the action of the Income Tax Unit in prorating the entire net earnings for the year 1918 in the determination of the amount of such earnings available for dividends, and in deducting from such earnings thus ascertained the accrued taxes up to the dividend dates.

It is stated that the nature of the business engaged in by the appellant enables it to keep its accounts in such a manner as to determine its profits within a reasonable degree of accuracy, monthly, upon the basis of perpetual inventories; that physical inventories were taken on June 30 and December 31 of 1918 as well as in other years and that the book inventory on those dates has consistently been adjusted to the physical inventory; that the books were actually closed on both dates and the income accurately determined; that the income from January 1, 1918, to June 30, 1918, thus determined was 1.51x dollars; that the net income for the full year ended December 31, 1918, was 1.12x dollars resulting from a net loss from operations in the latter half of the year; and that dividends in the amounts of .02x dollars and 1.12x dollars were paid on March — and May —, 1918, respectively.

In computing the deductions from invested capital for 1918 on account of the dividends paid on May —, 1918, the Unit averaged the earnings for the



full year monthly and from this average deducted the taxes accrued up to the dividend date.

The Unit states in its memorandum to the Committee that it has interpreted article 857 of Regulations 45 to mean that unless an actual closing of the books was made at the dividend date the earnings for the entire year should be averaged monthly.

That article of the regulations provides in substance that average earnings shall be used "unless the corporation shows from its books or other records that a greater proportion of its earnings for the year was available on such date," which provision follows in substance the law itself, section 201(e) of the Revenue Act of 1918. This section provides that if the books of a corporation do not show the amount of such earnings or profits to any definite date, the earnings or profits for the accounting period shall be deemed to have been accumulated ratably during such period.

In view, therefore, of the express provisions of the statute, and the regulations issued thereunder, the Committee finds no authority for the Unit's interpretation of article 857, as stated above. It is therefore recommended that the Unit's action in prorating the earnings for the entire year in determining the amount of such earnings available for the dividend paid on May —, 1918, be reversed, that the earnings shown by the books on June 30, 1918, be deemed to have been accumulated ratably from January 1 to the dividend date, May —, and that the deduction from invested capital be recomputed accordingly.

The appellant's representative's protest against the alleged illegality of that portion of article 857 of Regulations 45 which provides that accrued taxes shall be deducted in determining the amount of earnings available for dividends seems to have been filed more as a matter of record than as a serious contention in this appeal. It was admitted at the oral hearing that until this article was changed the Unit's action in following it was correct. This provision has several times in the past been reconsidered and each time adhered to by the Bureau. There is, in this case, no sufficient reason to recommend a change in the established practice relative thereto, and it is therefore recommended that the Unit's action on this point be sustained.

KINGMAN BREWSTER,

*Chairman Committee on Appeals and Review.*





**Law Section 326.—Invested Capital (1918 Act—¶555, ante): (1921 Act—¶1035, post).**

**Article 858.—Effect of Ordinary Dividend (Reg. 45—¶813, ante): (Reg. 62—¶1229, post).**

26-19-598: O. 942.

The exchange of  $x$  shares of common stock for one of preferred stock whereby the capital stock is reduced is a capital transaction and does not result in net income or earned surplus. Whether such a transaction gives rise to a paid-in surplus not decided.

An amount taken from capital or paid-in surplus to meet dividend requirements is deemed a liquidation of capital to that extent and necessitates a reduction in the invested capital. The sum so received by a stockholder is to be regarded as a return of capital so far as it does not exceed the cost of the stock to him, or if acquired prior to March 1, 1913, its fair market value on that date, any excess being taxable as a gain or profit. In case of subsequent payments from capital or liquidation payments upon dissolution, all prior distributions from capital should be considered in determining whether there has been a gain over the cost of the stock or its fair market value as of March 1, 1913.

Dividends paid while there is an operating deficit shall be deemed to be from capital or paid-in surplus, even though there are earnings of the taxable year sufficient to pay the dividend in whole or in part.

The taxpayer, the M Company, is a holding company owning the stock of about  $y$  companies. On December 31, 1917, the taxpayer had a surplus. Such surplus was produced in past years largely by the cancellation of common stock in this manner— $x$  shares of common exchanged for one of preferred. An analysis of the surplus account, it is stated, will show that most of the surplus is the result of the exchanges of stock, and if such items were eliminated there would be a deficit.

The questions to be decided are: (1) What is the nature and the result of the transaction by which  $x$  shares of common stock were exchanged for one of preferred? (2) What is the effect of payments to stockholders from capital or paid-in surplus? (3) What is the nature and effect of the dividend payment in this case? (4) Does the fact that an operating deficit would exist if the items in the surplus account resulting from such exchange of stock were eliminated affect the result in this case? (5) Whether invested capital can be increased by the accumulation of an earned surplus when an operating deficit exists, or whether current earnings must first be applied to repair the deficit?

(1) What is the nature and the result of the transaction by which  $x$  shares of common stock were exchanged for one of preferred stock? Such a transaction whereby the capital stock is reduced is a capital transaction and does not give rise to net income or earned surplus. (Article 542, Regulations 45.) Whether such a surrender of stock gives rise to a paid-in surplus or not is a question depending upon facts which are not disclosed by the taxpayer, and no decision is made upon this question. (Article 561, Regulations 45.)

(2) What is the effect of payments to stockholders from capital or paid-in surplus? A distribution of any part of the capital or paid-in surplus is to be regarded as a return to the stockholder of part of the capital represented by his shares of stock. Upon a subsequent sale of such stock, his profit will be the excess of the selling price over the cost to him of such stock or its fair market value as of March 1, 1913, after applying on such cost or value the amount of any such capital distribution. (See article 1549, Regulations 45.) Profits are the only proper source of dividends, and the declaration of dividends when there are no profits is contrary to law. (Conington, Corporate Organization and Management, p. 399; Thompson on Corporations, Article 5312.) That a surplus such as here considered is capital and not subject to distribution as dividends has been expressly held many times.

(See *Roberts v. Roberts-Wick Co.*, 184 N. Y. 257, 77 N. E. 13, and cases therein cited.) See also section 201 (a) (1) of the Revenue Act of 1918.

(3) What is the nature and effect of the dividend payment in this case? The dividend paid in February, 1918 (assuming that the taxable year of this corporation is the calendar year), is deemed to have been paid, first, from earnings and profits accumulated since February 28, 1913, and on hand at the beginning of the year; second, if that fund is insufficient, from earnings of the taxable year available on the date that the dividend is paid; third, if those funds are insufficient, from earnings and profits accumulated prior to March 1, 1913; fourth, if those funds are insufficient, from capital or paid-in surplus. (See section 201, Revenue Act of 1918; article 858, Regulations 45.)

In this case there is no earned surplus on hand at the beginning of the year, so that the only question is whether the earnings of the taxable year (class 2) are available for the payment of dividends when there is an operating deficit, or whether such dividends must be deemed to be a distribution of capital. This is not a question which should turn upon the legality of such a dividend in the particular jurisdiction, but is a question depending largely on accounting principles and business practice. From that standpoint there is no doubt but that current profits should be applied to make good the existing deficit before any dividends are distributed. (Dickinson, *Accounting*, p. 73.) It is the weight of authority in the United States, moreover, that the declaration of a dividend out of current profits, while there is an operating deficit, is contrary to law. (Conyington, *Corporate Organization and Management*, p. 399.) It is, therefore, held that the dividend in this case was the distribution of capital. It reduces the invested capital and should be treated as a return of capital to the stockholder.

This decision is based on the fact, as stated by the taxpayer, that the M Company is a holding company, owning the stocks of *y* different corporations. Whether this principle is applicable to a corporation operating a property where the investment of the capital in wasting assets is contemplated, is not decided.

(4) Does the fact that an operating deficit would exist if the items in the surplus account resulting from such cancellation of stock were eliminated affect the result in this case? The Regulations do not require a reduction in invested capital because of an operating deficit. (Article 860, Regulations 45.) They do require, however, a reduction in invested capital where there has been a distribution in liquidation, or a return of capital to the stockholders. The existence of an operating deficit, therefore, does not directly affect the invested capital and is significant in this case only as it throws light upon the sources from which the dividend here in question was paid.

(5) May invested capital be increased by the accumulation of an earned surplus when an operating deficit existed, or must the earnings of the taxable year be applied to repair the deficit? The law defines invested capital as cash or property paid in for stock, earned surplus, and undivided profits and paid-in surplus. The act does not require a reduction of invested capital on account of an operating deficit. It is obvious, however, that no earned surplus can be accumulated until the deficit or impairment of paid-in capital has been made good. (Article 838, Regulations 45.)

It is held, therefore, that the exchange of *4x* shares of common stock for one of preferred stock whereby the capital stock is reduced is a capital transaction and does not result in net income or earned surplus. Whether such a transaction gives rise to a paid-in surplus not decided.

An amount taken from capital or paid-in surplus to meet dividend



requirements is deemed a liquidation of capital to that extent and necessitates a reduction in the invested capital. The sum so received by a stockholder is to be regarded as a return of capital so far as it does not exceed the cost of the stock to him, or if acquired prior to March 1, 1913, its fair market value on that date, any excess being taxable as a gain or profit. In case of subsequent payments from capital or liquidation payments upon dissolution, all prior distributions from capital should be considered in determining whether there has been a gain over the cost of the stock or its fair market value as of March 1, 1913.

Dividends paid while there is an operating deficit shall be deemed to be from capital or paid-in surplus, even though there are earnings of the taxable year sufficient to pay the dividend in whole or in part.

1

20-20-943: A. R. M. 51.

## REVENUE ACT OF 1917.

The Committee is in receipt of a request for advice upon certain points, which have been raised in connection with the audit of the return of the M Copper Company, and in connection with the audit of other copper companies.

It appears that during the year 1917, and prior to August 6, 1917, the M Company paid a dividend of approximately  $x$  dollars, which was declared to have been paid out of earnings accumulated prior to March 1, 1913. At the date of the dividend payment the excess of depletion allowable for 1917 on the basis of March 1, 1913, over the depletion actually sustained on the basis of cost, was an amount in excess of the dividend declared to have been paid out of earnings accumulated prior to March 1, 1913. The M Company therefore contends that before any impairment of invested capital as of December 31, 1916, is determined because of the dividend payment, there should be taken into consideration the realization of the appreciation in values as of March 1, 1913, which has been converted into cash and reflected on its books during the current year.

The question in connection with the other copper companies involves essentially the same point without the complication of the dividend. In the opinion of the Committee, neither contention is well taken. The M Company having by appropriate action declared the dividend out of earnings accumulated prior to March 1, 1913, and so advised its stockholders, will not now be heard to say that the dividend was actually paid out of earnings of the current year, and as will be subsequently developed in this memorandum the Committee is clearly of the opinion that appreciation prior to March 1, 1913, realized in the taxable year, is an earning of the taxable year and not an earning accumulated prior to March 1, 1913.

In the Baldwin Locomotive case (*Baldwin Locomotive Works v. McCoach*, 221 Fed. 59) it was held that appreciation in values is not earnings or profits until realized. This decision was rendered under the Act of 1909, and following it no appreciation in the value of corporate properties to March 1, 1913, was reported or tax paid as income or earnings notwithstanding the Act of October 3, 1913, gave to such corporations the right to fix value as of March 1, 1913, including appreciation, as the basis for any subsequent gain or loss.

Following this decision and the decisions of the Supreme Court as to the taxation of appreciation to March 1, 1913, it is clear that the realization of such appreciation is an earning of the year in which such appreciation is realized, although under the latter decisions it is not a taxable earning.

Since the excess profits tax law definitely holds that earnings of the taxable year are not to be included in earned surplus or undivided profits, realization of appreciation in values to March 1, 1913, is not a proper addition to invested capital as the realization takes place, as contended for by the companies.

It is therefore held that the dividend payment of the M Company must be deemed to have been paid from earnings or profits realized prior to March 1, 1913, and therefore that the invested capital of the company must be reduced by that amount; and secondly, that realization during the taxable year of appreciation in values to March 1, 1913, can not be included in the invested capital of the taxable year.

2

9-21-1488: A. R. R. 408

Held, that the expression, in a declaration by the directors of a corporation, that a dividend is "payable as convenient to the funds of the company" creates a condition precedent. Dividends so declared are not necessarily to be considered payable as of the date of the declaration.

The Committee has under consideration the appeal of the M Company from an additional assessment made by the Income Tax Unit for the years 1917 and 1918. The single question at issue is: Whether the declaration of a dividend expressed in terms to be *payable as convenient to the funds of the company* of necessity imported a diminution of invested capital and surplus to an amount commensurate with the gross sum of the contemplated dividend, required to be adjusted as of the date of the dividend's declaration instead of as of the time or times of its actual payment.

Dividends were declared by this corporation in January, April, and July, 1917, and in the year 1918 in June, July, and October. In each instance the resolution of the board of directors was expressed in the terms to be "payable as convenient to the funds of the company." The first dividend in 1917 was actually paid in 10 installments between the dates of January 23 and May 29, inclusive, and the payments of the remaining dividends declared were, with the exception of that of October, 1918, made over similar extended periods of time and in varied amounts. The dividend declared October, 1918, was paid November, 1918.

In the current adjustment of invested capital in each of the taxable years the Income Tax Unit used the date of declaration of the dividends as the date of payment. The corporation contends that the actual dates of payment should govern.

It is not shown in the facts submitted in this case whether the dividends were actually accrued on the books of the corporation as of the dates when declared, or whether the charge was made against income of the taxable years at the time the payments were made.

Article 858 of Regulations 45, on which the Income Tax Unit relied in making its adjustment, reads as follows:

A dividend other than a stock dividend affects the computation of invested capital from the date when the dividend is payable and not from the date when it is declared, except that where no date is set for its payment the date when declared will be considered also the date when payable for the purpose of this article.

The regulations, as above quoted, clearly contemplate that a dividend must not affect the computation of invested capital, except from the date when the dividend is payable. In the instant case, the date payable is when the funds of the company are convenient. It is considered by the Committee that the expression "except where no date is set for its payment



the date when declared will be considered also the date when payable" is on the assumption that the corporation has resources to pay and does immediately intend to pay. When the corporation can conveniently pay the dividend, so declared out of the funds of the company, is a matter of administrative decision by the officers of the company and until such decision, as a condition precedent, is reached there is, in effect, no dividend to be paid and no reciprocal right on the part of stockholders to immediately exact payment. The dividend resolutions were merely tentative declarations of the corporation's intent to pay certain dividends at a subsequent date to be determined by the condition of the company's treasury.

The Committee is accordingly of the opinion that the Income Tax Unit erred in considering the dates of the resolutions of the directors as determining the dates when the dividends were payable and recommends that computation of invested capital be revised to give effect to the condition precedent which makes the dividend, in each instance, payable when the funds are conveniently available.

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(See 34-21-1786; Sec. 325, Article 813-9 (6).) Dividend credited to stockholder left in the business.

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42-21-1876; O. D. 1070.  
Where a corporation issues interest-bearing notes to its stockholders in lieu of a cash dividend, invested capital should be reduced as of the date of the notes, provided the dividend was not declared from current earnings.

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I ('22)—15-221: I. T. 1279.  
**Revenue Act of 1918.**

The payment of taxes by a bank on behalf of its shareholders should be treated, as respects invested capital, in the same manner as other distributions by a bank to its shareholders, and if the payment of such taxes is in an amount sufficient to have caused an adjustment in invested capital during the year in which paid, if such payment had been in the form of a dividend, an adjustment should be made in invested capital on account of the taxes paid as of the date of payment.

6

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**Revenue Act of 1918.**  
(See I. T. 1286; Sec. 326, Art. 838-8 (8).) Dividends paid during the existence of an operating deficit.

7

I ('22)—19-263: Sol. Op. 140

**Revenue Act of 1918. Dividends. Invested Capital.**

Where earnings and profits accumulated from March 1, 1913, to the beginning of the taxable year are insufficient to cover dividends during the first 60 days of the taxable year but there are available for payment of such dividends not only sufficient earnings and profits of the taxable year but also sufficient undivided profits accumulated prior to March 1, 1913, any such dividends in excess of earnings and profits accumulated from March 1, 1913, to the beginning of the taxable year shall be considered as paid from earnings and profits of the taxable year and, accordingly, invested capital of the corporation as of the beginning of the taxable year shall not be reduced by the amount of such excess.

An opinion has been requested upon the question whether dividends paid by the M Company during the first 60 days of the taxable year 1918 should be treated as paid out of the accumulated earnings and profits of previous taxable years. This corporation had on December 31, 1917, outstanding capital stock fully paid up of the par value of 8x dollars and undivided profits amounting to 87x dollars. It paid dividends during the first 60 days of 1918 as follows: January 12, 1.2x dollars; January 18, 1.2x dollars; February 4, 1.2x dollars; February 13, 1.2x dollars; February 21, 1.2x dollars; and February 28, 1.2x dollars; a total of 7.2x dollars. March 1, 1913, it had undivided profits amounting to approximately 82x dollars. It has been the practice of this corporation since 1911 to distribute dividends as fast as its profits were earned. The dividends have been uniformly 1.2x dollars and have been paid at intervals varying from one week to one month. The president of the corporation has filed an affidavit stating that the dividends above enumerated were paid out of profits earned in 1918. The corporation seeks exceptions from the rule stated in article 858 of Regulations 45 (1920 edition) that—

\* \* \* The surplus and undivided profits as of the beginning of the taxable year will be reduced as of the date when the dividend is payable by the entire amount of any dividend paid during the first 60 days of the taxable year. \* \* \*

on the ground that the dividends in question were in fact out of current earnings.

Section 201(e) of the Revenue Act of 1918 provides:

Any distribution made during the first 60 days of any taxable year shall be deemed to have been made from earnings or profits accumulated during preceding taxable years; but any distribution made during the remainder of the taxable year shall be deemed to have been made from earnings or profits accumulated between the close of the preceding taxable year and the date of distribution, to the extent of such earnings or profits, and if the books of the corporation do not show the amount of such earnings or profits, the earnings or profits for the accounting period within which the distribution was made shall be deemed to have been accumulated ratably during such period.

The question is whether the phrase "shall be deemed" as used in the first clause of section 201(e) creates a conclusive presumption. It will be observed that the phrase is used three times in the subdivision. It is used six times in section 201, and many times in other parts of the statute. Nowhere does it appear to be used to create merely a rebuttable presumption, except in section 402, where the language is "shall, unless shown to the contrary, be deemed." The presumption, therefore, must be held to be conclusive.

While the presumption is held to be conclusive, the statute must be construed so as to give effect to all its provisions. The intention of section 201 of the Revenue Act of 1918 was to relieve from the tax dividends paid by a corporation out of earnings and profits accumulated prior to March 1, 1913. The Act provides, however, that before such earnings and profits may be distributed (free from tax) the corporation must first distribute its earnings and profits accumulated since March 1, 1913. This result is reached by section 201(b), which provides:



\* \* \* Any distribution made in the year 1918 or any year thereafter shall be deemed to have been made from earnings or profits accumulated since February 28, 1913, \* \* \* but any earnings or profits accumulated prior to March 1, 1913, may be distributed \* \* \* exempt from tax, after the earnings and profits accumulated since February 28, 1913, have been distributed.

To construe the language of section 201(e) so as to hold that a distribution was made from earnings or profits accumulated prior to March 1, 1913, while there was still on hand earnings or profits accumulated since March 1, 1913, would be holding that this paragraph was in conflict with the language just quoted from paragraph (b) of the same section. However, construing the two paragraphs together, they provide that any distribution made during the first 60 days of the taxable year shall be deemed to have been made from earnings and profits accumulated during preceding taxable years, but all earnings and profits accumulated since March 1, 1913, must be distributed before earnings and profits accumulated prior to March 1, 1913, may be distributed free from tax. The presumption contained in the first part of section 201(e) therefore applies only to earnings and profits accumulated between February 28, 1913, and January 1, 1918, and has no application to earnings accumulated in any other period. If the earnings or profits accumulated for the period from March 1, 1913, to January 1, 1918, are not sufficient to pay the dividends declared during the first 60 days of the taxable year, and there are other profits accumulated after March 1, 1913, such earnings and profits are to be applied to the dividends so declared.

In Advisory Tax Board Recommendation 43 (C. B. 1, pp. 26-27) the case considered was that of a corporation paying dividends during the first 60 days of 1918. It had no surplus earned between March 1, 1913, and January 1, 1918, but had surplus earned prior to March 1, 1913, and also sufficient earnings accumulated after January 1, 1918, and prior to each of such dividends out of which to pay it. It was held that the 60-day presumption was inapplicable and that the dividends were paid out of the earnings of 1918.

In Law Opinion 942 (C. B. 1, pp. 300-302) a case was considered where a corporation paid a dividend during the first 60 days of 1918. In the course of the opinion it was ruled, following Advisory Tax Board Recommendation 43, that if earnings and profits accumulated since February 28, 1913, and on hand at the beginning of the taxable year were insufficient to cover such dividend, a dividend paid during the first 60 days of the taxable year is deemed to be paid out of earnings of the taxable year.

In the present case there is no compelling reason for departing from previous rulings. It is held, therefore, that the dividends paid by the taxpayer during the first 60 days of 1918 were paid out of earnings and profits accumulated during the period from March 1, 1913, to January 1, 1918, to the extent of such earnings and profits on hand on January 1, 1918, which sum is to be determined by deducting from the earnings and profits of that period the dividends paid during that period, and that the balance of dividends paid during the first 60 days of 1918 were paid from earnings and profits of 1918. The invested capital of the taxpayer should be reduced by prorating such dividends paid out of earnings and profits accumulated from March 1, 1913, to January 1, 1918, but not such dividends paid out of earnings and profits of 1918.

CARL A. MAPES,  
*Solicitor of Internal Revenue.*

I ('22)-20-283: I. T. 1314

**Revenue Act of 1918.**

The M Company, a foreign corporation, is a subsidiary of the O Company (known as the parent company), a domestic corporation. All of the stock of the former company is owned by the latter. The stock of the foreign company is being distributed to the stockholders of the domestic company. The question is presented as to whether the distribution of the stock of the subsidiary company among the stockholders of the parent company reduces the capital and surplus account of the parent company by the amount of the value of the stock so distributed.

Held, in view of the conclusive presumption in section 201 of the Revenue Act of 1918 that any distribution made by a corporation after the first 60 days of any taxable year shall be deemed to have been made out of earnings and profits accumulated since the close of the preceding taxable year, that such distribution will not affect the invested capital of the parent company, provided the earnings for the current year as of the date of the distribution available for dividend purposes equaled the amount at which such stock was included in the invested capital of the company as of the beginning of the current year.

If the available earnings for the current year as of the date when the distribution took place were not sufficient, the invested capital as of the beginning of the year would be reduced accordingly.

9

I('22)-26-377: I. T. 1375

**Revenue Act of 1921.**

With reference to a corporation having a fiscal year ending November 30, which discontinued its business and sold its plant in December, 1920, and which went into liquidation and paid a dividend on December 15, 1920, from the profits in part from the sale of the plant, it was held:

That under the provisions of section 201(f) of the Revenue Act of 1921 a dividend paid during the first 60 days of a taxable year is presumed conclusively to have been paid from earnings or profits accumulated during the preceding taxable years, so far as they are available, and that this presumption can not be rebutted by showing that earnings were accumulated during the first 60 days of the taxable year in an amount sufficient to pay the dividends in whole or in part.

That the surplus and undivided profits of the corporation on hand at November 30, 1920, which represented earnings accumulated during the period from March 1, 1913, to November 30, 1920, must be first applied against the amount of the dividend paid December 15, 1920.

That in case this dividend exceeded the amount of the surplus and undivided profits available for its payment, the excess will be deemed to have been paid out of the earnings of the taxable year available at the date when the dividend was paid, and that to the extent that such earnings are insufficient, the dividend will be deemed to have been paid out of the earned surplus accumulated prior to March 1, 1913, or to be a liquidation of paid-in surplus or capital.

The above methods of allocating the dividend must be followed, although profits were realized by the corporation through the sale of its plant December 1920, which were actually applied to the payment of the dividend.

10



**Law Section 326.—Invested Capital (1918 Act—¶555, ante): (1921 Act—¶1035, post).**

**Article 859.—Effect of Stock Dividend (Reg. 45—¶814, ante): (Reg. 62—¶1230, post).**

1-19-7: T. B. R. 3.

Under the Revenue Act of 1917 stock dividends paid during any taxable year, and under the Revenue Act of 1918 stock dividends paid after the first 60 days of any taxable year, shall be deemed to have been paid from earnings or profits, but the payment of a stock dividend has no effect upon the amount of invested capital.

In determining the amount by which invested capital should be reduced on account of dividend payments made during the taxable year in excess of current earnings, should stock dividends be treated the same as cash dividends?

The following example illustrates the point in question:

Current earnings to Apr. 1, 1917.....	\$33,000
Stock dividends, Apr. 1, 1917.....	30,000
Balance current earnings undistributed.....	3,000
Earnings for April, 1917.....	12,000
Current earnings on hand May 1, 1917.....	15,000
Cash dividend May 1, 1917.....	27,000
Dividend payments in excess of current earnings.....	12,000
12,000 averaged for eight months.....	8,000

which is the amount by which invested capital as of the beginning of the year should be reduced.

The provisions of section 31 (a) of the Revenue Act of 1917, and section 201 of the Revenue Act of 1918, place stock dividends upon the same basis as cash dividends in this connection. The latter section provides, "That the term 'dividend' \* \* \* means any distribution made by a corporation \* \* \* whether in cash or in other property or in stock of the corporation out of its earnings or profits accumulated since February 28, 1913," and the definition in the Act of 1917 is substantially the same. Section 31 (b) of the Act of 1917 provides that any distribution made during the year shall be deemed to have been made from the most recently accumulated undivided profits or surplus. Section 201 (e) of the Act of 1918 provides that any distribution made after the first 60 days of any taxable year shall be deemed to have been made from current earnings or profits so far as possible. The language of these provisions is general and is susceptible of only one interpretation. It applies to all distributions of earnings, whether made in cash or in other property or in stock of the corporation. And any such distributions in excess of earnings or profits of the taxable year will reduce the surplus at the beginning of the taxable year by the amount of such excess.

The payment of a stock dividend, however, has no effect upon the amount of invested capital, article 859, Regulations 45 (final edition). The distribution of a stock dividend is in effect a capitalization of current earnings or of earned surplus on hand at the beginning of the year. The capitalization of current earnings does not increase the invested capital and the capitalization of surplus on hand at the beginning of the year does not decrease the invested capital. Nevertheless a stock dividend distributed at any time during the year under the Act of 1917 or after the first 60 days of the taxable

year under the Act of 1918 must be deemed to have been paid from current earnings or profits so far as possible, so that the accumulated earnings or profits of the taxable year available thereafter for cash dividends or other payments are correspondingly reduced. In the specific illustration given, therefore, the result is correct, but in a case in which the stock dividend was in whole or in part a capitalization of the surplus on hand at the beginning of the taxable year, no reduction in invested capital should be made because of the capitalization of such surplus.

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II('23)-4-830: I. T. 1633.

### Revenue Act of 1918.

During 1914 a corporation declared a stock dividend at a date when its surplus was sufficient to cover the amount of the dividend. A net operating loss was sustained for that year, however, so that at the close of the year the corporation's balance sheet showed a deficit by reason of the dividend declared. In 1915 a very large net loss was sustained and the stockholders returned to the corporation a majority of the stock which they had received through the stock dividend distributed during the preceding year.

The question was submitted as to whether the declaration and distribution of the stock dividend created paid-in capital stock within the meaning of section 326 of the Revenue Act of 1918, so that the stock distributed through the dividend would not be affected by a subsequent operating deficit, and whether the return of a portion of this stock by the stockholders created paid-in surplus.

Held, that the conversion of earned surplus into capital stock through the declaration of a stock dividend did not create paid-in capital stock within the meaning of section 326 of the Revenue Act of 1918. The invested capital of the corporation, in so far as it was represented by the capital stock thus created, was subject to reduction on account of an operating deficit. The return of a portion of the stock received through the stock dividend, as a donation by the stockholders, did not create paid-in surplus equivalent to the par value of the stock donated.

2



Law Section 326.—Invested Capital (1918 Act—¶555, ante): (1921 Act—¶1035, post).

Article 860.—Impairment of Capital (Reg. 45—¶815 ante): (Reg. 62—¶1231 post).

II ('23)-5-860: I. T. 1649.

### Revenue Acts of 1918 and 1921.

The conversion of earned surplus into capital stock through the medium of a stock dividend does not exempt the capital of a corporation, to the extent that it was derived from earned surplus, from reduction on account of a subsequent operating deficit in computing invested capital.

A corporation was organized with a paid-in capital stock of 50x dollars which was later increased to 250x dollars through a stock dividend of 200x dollars declared out of earned surplus. Subsequent to the declaration of the stock dividend the corporation suffered operating losses for several years which caused a total operating deficit of approximately 80x dollars.

The question was submitted as to whether in computing the invested capital of the corporation it was entitled to the benefit of its full 250x dollars capital stock without any deduction for the operating deficit, or whether article 860, Regulations 45, refers only to the original capital paid in, and, therefore, requires a reduction to be made on account of any operating deficit to the extent of the stock dividend declared.

Held, that the conversion of earned surplus into capital stock through the medium of a stock dividend does not exempt the capital of a corporation, to the extent that it was derived from earned surplus, from reduction on account of a subsequent operating deficit in computing invested capital and that the invested capital of the corporation should be reduced by 80x dollars, although no reduction had taken place in its outstanding capital stock.





**Law Section 326.—Invested Capital (1918 Act—¶555, ante): (1921 Act—¶1035, post).**

**Article 862.—Purchase of Stock (Reg. 45—¶817, ante): (Reg. 62—¶1233, post).**

18-20-891: O. D. 479.

A corporation issued additional shares of stock equal to approximately 7 per cent of the amount previously outstanding, using the proceeds from the sale of the stock to purchase an additional plant which, however, was later abandoned as a manufacturing plant and sold. The proceeds of this sale were used to purchase equipment for carrying out Government contracts during the war. Upon the completion of the contracts the corporation had more funds than were needed in its business and retired approximately twice the amount of additional stock previously issued, paying for each share an amount in excess of its par value. The amount representing the par value of the stock was charged to capital account, and the amount paid in excess of its par value was charged to surplus accumulated prior to March 1, 1913. After the distribution, the corporation had no greater surplus than was reasonably required for the needs of its business.

Held, that the distribution was not a dividend within the meaning of section 201 (a) and (b) of the Revenue Act of 1918, but was a distribution in part liquidation of the corporation within the meaning of section 201 (c) of the Act.

The transaction should be treated as a voluntary purchase by the corporation of its capital stock for the purpose of its retirement, and the entire cost of such stock is a required deduction from invested capital of the company as of the beginning of the taxable year and effective from the date of purchase only to the extent that such stock has not been purchased out of the undivided profits of the taxable year.

The stockholders who sold their stock to the company should return as income, subject to both the normal and additional taxes, any excess over and above the cost of the stock to them, or its fair market value as of March 1, 1913, if acquired prior thereto.

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51-21-1984: A. R. R. 693.

#### REVENUE ACT OF 1917.

Recommended, in the appeal of the M Company that the action of the Income Tax Unit in disallowing as a deduction from gross income the excess of the book value on January 1, 1917, of certain assets transferred over the book value as of that date of y shares of its capital stock acquired by such transfer and carried to treasury stock account, be sustained, and accordingly that the taxpayer's appeal be denied.

The Committee has had under consideration the appeal of the M Company from the action of the Income Tax Unit in disallowing a deduction for losses amounting to 13x dollars and claimed in the appellant's 1917 income and profits tax return.

The transaction giving rise to the point at issue may be briefly summarized as follows: The M Company was the operator of several stores which were located in different cities. The several stores were merely branches of the business, and were not separately incorporated. According to the records in the case, and the statements made by the appellant therein, the branch store located in Z was not operated with satisfactory results, and it had been the desire of the concern for some time prior to 1917 to divest itself of this branch business. It is shown that in October, 1917, agreement

was made and contract entered into whereby the appellant transferred to A (one of its stockholders) the entire assets, business, good will, etc., of the branch store located in Z in consideration of y shares of its own capital stock, which at that time were owned and held by said A.

The taxpayer submits that book values as of January 1, 1917, as shown by its books on that date, were 67x dollars for the branch store at Z and 53x dollars for the y shares of stock held on that date by A. It is the taxpayer's contention that the transaction was one of sale wherein it sold capital assets (the Z business including physical assets, fixtures, inventory, good will, etc.), having a value of 67x dollars, which was in excess of the consideration received therefor (y shares of capital stock valued at 53x dollars), and consequently sustained a loss to the extent of such difference between values as might properly be deducted in computing taxable net income under the provisions of the Revenue Act of 1916, as amended by the Revenue Act of 1917, section 12(a)2. This provision of law reads that in the ascertainment of net income there shall be deducted:

All losses actually sustained and charged off within the year and not compensated by insurance or otherwise. \* \* \*

The Income Tax Unit in its consideration of this question has held that the transaction was a capital one, i.e., one in which the appellant had purchased its own capital stock for a consideration, and that under such transaction, whether the consideration for such purchase of stock be in money or money's worth, there results no taxable gain or deductible loss for tax purposes. Accordingly, the amount deducted by the appellant has been restored to taxable net income and the necessary adjustment of invested capital has been made, resulting in an additional tax which the Unit proposes to assess. It is from such holding and proposed action on the part of the Unit that the taxpayer appeals.

It is apparent, therefore, that the question for determination by the Committee is whether the transaction is a capital one involving no gain or loss as contended by the Unit or one of sale consummated by the appellant wherein was sustained a loss which may properly be deducted in the computation of taxable net income as contended by the taxpayer. The taxpayer in contending for the latter view makes the following comments:

The Government takes the position that this was not a sale of the Z store, but a purchase of the shares in the corporation and that the excess of the value of the assets sold over the value of the stock received in payment therefor is a premium paid for the return of the shares to the corporation. This is entirely unjustified and we are unable to see upon what theory the Government can so distort the facts as to change a legitimate transaction from a sale into a purchase. The store in Z was the least successful of the stores owned by the corporation and was the subject of the most care and trouble. The motive which prompted the entire transaction was to be rid of the Z business. The sale was a legitimate one and the stock would not have been purchased under any circumstances had it not been taken in payment for the Z store. The transaction is closed and there is no reason why the loss can not be deducted.

The return in question was filed under the Act of September 8, 1916, as amended by the Act of October 3, 1917, and the loss is properly deductible under section 12(a) second, which provides for the deduction of "all losses actually sustained and charged off within the year and not compensated by insurance or otherwise." Attention is called to articles 101 and 124 of Regulations 33, revised, interpreting the Act under which this return was filed. The taxpayer is supported by the wording of the regulations in question.

If the M Company had taken in exchange for the Z store capital stock in its own company having a book value of 80x dollars, would the Government hold that the M Company was not obliged to return as income for the year 1917 the difference between 80x dollars and 67x dollars? We think not; and if a profit from such a sale is taxable and must be included in a return, then it follows that a loss is deductible.

If the M Company had taken from A, the purchaser of the Z store, a check for 53x dollars and had immediately purchased from A his y shares in the M Company for 53x



dollars, giving him a check therefor, the Government would not have objected to the M Company claiming as a loss the difference between the value of the capital assets sold and the 53x dollars, but because the M Company dealt openly and above board and did not resort to an exchange of checks in the manner indicated, they are penalized for their honesty.

If the M Company had taken in exchange for the sale of the assets in question Liberty bonds or other securities of the value of the stock of the M Company taken in exchange, the Government would raise no objection to the deduction of the loss in question, and it is seriously contended that the medium of payment can make no difference in the principle involved in the transaction in question. We call the Government's attention to the regulations on dividend disbursements in which it is distinctly held that the medium of payment makes no difference.

It is observed that the appellant attempts to justify its position in this matter by applying article 101 of Regulations 33, revised, which provides:

*Income from sale of capital assets.*—If a corporation sells its capital assets in whole or in part, it will include in its gross income for the year in which the sale was made an amount equivalent to the excess of the sales price over the fair market price or value of such assets, as of March 1, 1913, if acquired prior to that date, or over cost, if acquired subsequent to that date. \* \* \*

It is noted also that the taxpayer submits that had the book value of its own stock acquired in this transaction been in excess of the book value of the assets transferred therefor, the Government would have sought to tax such excess as a taxable gain or profit. The Committee has given thorough consideration to all of the arguments, briefs, and data submitted regarding the character of the transaction and the respective values of the assets and capital stock involved therein, and finds itself unable to sustain the view of the taxpayer.

It is the opinion of the Committee that as contended by the Unit the transaction was a capital one within the meaning of the law as defined by the regulations and not a sale of capital assets as argued by the taxpayer. That this transaction was one in which the appellant purchased its own stock rather than sold capital assets, seems to be borne out by the language of the contract entered into by it and A in 1917. The pertinent portion of that contract is here quoted:

This contract entered into this — day of October, 1917, between the M Company and A, witnesseth:

A sells to the M Company y shares of the capital stock of the M Company. In payment of said shares the M Company agrees as follows: \* \* \*

(In the contract there follow certain stipulations relating to the payment and other things to be done by the M Company as considerations for the acquisition of y shares of its capital stock.)

The position taken by the Committee in this connection seems to be borne out further by articles of the regulations, legal opinions, and accounting authorities hereinafter quoted.

Article 98 of Regulations 33, revised, issued under the Revenue Act of 1916, as amended by the Act of 1917, provides:

*Treasury stock—When taxable.*—Treasury stock wherever and whenever that term is used in connection with the accounts of the corporation or for income tax purposes, will be held to mean stock which had been previously issued by the corporation and which had been repossessed by it through purchase or otherwise, and then carried on its books as an asset. If such stock is resold at a price in excess of its cost upon repossession, such excess shall be returned as income for the year in which resold. \* \* \*

Article 542 of Regulations 45 issued under the Revenue Act of 1918 provides in part as follows:

*Sale of capital stock.*— \* \* \* If the corporation purchases any of its stock and holds it as treasury stock, the sale of such stock will be considered a capital transaction, and the proceeds of such sale will be treated as capital and will not constitute income of the corporation. A corporation realizes no gain or loss from the purchase of its own stock. See articles 563, 861, and 862.

It should be here noted that the regulations issued under the two Acts materially differ so far as concerns the subsequent sale of treasury stock acquired by the issuing corporation after originally issued. This question, however, is not germane to the case under consideration and may be passed by merely stating that the provisions of article 542, Regulations 45, supersede article 98 of Regulations 33, revised, and should control in all cases involving such circumstances. While article 542 of Regulations 45 is issued under the Revenue Act of 1918 and applies primarily to returns filed under that Act, it is equally applicable to returns under prior Acts and is controlling in the instant case in that portion thereof which reads:

A corporation realizes no gain or loss from the purchase of its own stock.

As before stated, the Committee is of the opinion that the transaction involved is a capital one, and that for the purpose of determination it is immaterial that the consideration given in exchange for the capital stock repurchased was not money but money's worth, such as in the instant case.

The Solicitor of Internal Revenue stated in his Law Opinion 296 (not published), issued under the Revenue Act of October 3, 1913, that:

A corporation does not derive income from the acquisition of its own capital stock for cancellation.

In the discussion of the case under consideration at that time the Solicitor stated that:

The O Company was doing a prosperous business, and a syndicate was formed which secured control of all of its capital stock. The P Company was then organized which purchased for cash from the syndicate all of the shares of the company except directors' or qualifying shares. The P Company then had the O Company deed to it approximately 90 per cent of its assets in payment for which the P Company surrendered to the O Company 90 per cent of the capital stock of the O Company. The transaction was carried through, and the 90 per cent of the stock surrendered was canceled. \* \* \*

In the argument of the question under discussion the Solicitor stated:

The stock of a corporation held by any person other than the corporation which issued it of course constitutes an asset and one receiving in exchange capital stock of ascertained market value greater than the cost to him of the asset given in exchange might realize a taxable profit from the transaction, but when stock is acquired by the corporation which issued it, in exchange for assets of the corporation, the transaction has an entirely different character. The stock is then necessarily diminished in value by the amount of the assets which the corporation has exchanged for it.

In the instant case, when the O Company acquired substantially all of its stock in exchange for 90 per cent of its assets, the stock immediately ceased to represent anything like its former value. The whole exchange from the standpoint of the O Company was a capital transaction; capital stock, a bookkeeping capital liability, was acquired and extinguished by a surrender of assets including capital assets, the beneficial interest in which was previously represented by the stock acquired. No income could or did accrue to the O Company from this transaction. Its capital account alone was affected. \*\*\*

It is observed that the Solicitor's law opinion just cited has to do with the question of taxable profit rather than a deductible loss as involved in the instant case, but it logically follows from the language of that opinion that the converse of the proposition would be true, and that under such circumstances where a taxable gain could not be realized, no deductible loss could be sustained. This latter view is supported by Solicitor's Law Opinion 426 (not published), issued under Revenue Act of 1916, in which the Solicitor held that:

\* \* \* Amounts paid by a corporation for the purchase of its capital stock for cancellation constitute capital transactions, and no part of the amounts paid is an allowable deduction from income as a loss sustained.

In the argument of the case under consideration at that time, the Solicitor states that:

\* \* \* This office has consistently held that where a corporation purchases its capital stock at a premium, it is not entitled to deduct the premium paid as a loss. Under



date of April 11, 1917, this office wrote a letter to an inquirer in which it was held: "You are informed that this office will hold that the redeeming of stock at a price in excess of par represents a capital transaction in which there can be no gain or loss to the corporation, and therefore, the difference between the selling price of the stock and the price at which it was redeemed will not be taken up in the return of annual net income."

Each of the above cases had to do with the acquisition and cancellation of its stock by the company issuing such stock, while in the instant case, the stock acquired was carried as "Treasury stock." In the judgment of the Committee this difference is not material in the disposition of the question involved, and the rule laid down by the Solicitor is applicable to the appellant case.

It does not appear necessary to enter into a discussion of the analyses of book values of the corporate assets transferred or of the capital stock reacquired in view of the position taken by the Solicitor. It has been heretofore shown in this opinion that the contract entered into by the M Company and A refers in no uncertain terms to a *sale* by A to the appellant of y shares of its capital stock for certain considerations named in payment therefor. It is also shown by a statement taken from the books of the appellant that this transaction was treated primarily as a capital transaction and that there has been set up a treasury stock account with appropriate debits and credits thereto.

Esquerre in his work entitled, "Applied Theory of Accounts," in speaking of accounting for treasury stock, states in part as follows:

\* \* \* No matter what the financing scheme may have been which suggested the purchase of stock, its purpose should have been accomplished without affecting the income since the question of reducing the capital stock liability was never at issue. It would undoubtedly be better accounting to accept the view that premiums on capital stock constitute liabilities while discounts constitute assets, or, at all events, that they represent facts which should be permitted to remain on the books until offset by subsequent transactions. Nor can it be said that such a treatment would be good financing since it would compel the supposed gains on discounts to remain in the business, while it would prevent the supposed losses on premiums from being charged to the present stockholders to the possible advantage of future stockholders.

In view of the foregoing matters, the Committee concludes that the transaction in the instant case was a capital one and not one in which there resulted a loss from the sale, exchange or other disposition of property such as may properly be deducted in the computation of taxable net income; therefore it is recommended, in the appeal of the M Company that the action of the Income Tax Unit in disallowing as a deduction from gross income the excess of the book value on January 1, 1917, of certain assets transferred over the book value as of that date of y shares of its capital stock acquired in such transfer and carried to treasury stock account, be sustained, and accordingly that the taxpayer's appeal be denied.

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I(22)—11-146; A. R. R. 799

#### Revenue Acts of 1917 and 1918.

Recommended, in the appeal of the M Company, (1) That the value of patents acquired by said company at date of organization be placed at  $144\frac{1}{2}x$  dollars and the value of good will, trade-marks, etc., be placed at  $37x$  dollars (these figures being subject to verification by the Unit under the principles of valuation herein stated); (2) that the corporation be allowed to amortize its patents in the taxable year 1918 on basis of 1/17 of the values recommended herein; (3) that the preferred stock purchased by the corporation and held as treasury stock be excluded in determining the statutory limitation on intangibles for purposes of invested capital; (4) that the corporation be denied its inventory adjustment at December 31, 1918, because net inventory loss has not been established; (5) that the cor-

poration be allowed the value of patents of A in the computation of prewar invested capital in accordance with the provisions of section 330 of the Revenue Act of 1918 and article 934 of Regulations 45; (6) that the corporation be allowed income from royalties on patents owned by A in computing prewar income in accordance with the provisions of section 330 of the Act.

The Committee has had under consideration the appeal of the M Company from the action of the Income Tax Unit in adjusting its tax returns for the taxable years 1917 and 1918.

The exceptions taken by the taxpayer are summarized as follows:

1. That the Income Tax Unit did not give proper value to patents acquired at date of incorporation of the M Company.

2. That the Income Tax Unit was in error in refusing to allow the appellant to depreciate its patents for the year 1918.

3. That the Income Tax Unit was in error in refusing to take into consideration (in determining the value of intangible assets for purposes of invested capital) the proper value of the preferred stock originally issued and aggregating 20x dollars.

4. That the Income Tax Unit was in error in refusing to allow the appellant the right to correctly value its inventory at December 31, 1918.

5. That the Income Tax Unit was in error in failing to compute the invested capital for the prewar period in the same way as that employed in computing invested capital for the taxable year, as required by section 330 of the Revenue Act of 1918.

6. That the Income Tax Unit was in error in excluding from the war profits credit, in violation of section 330, the net profits of one of the businesses acquired by the appellant at time of its organization, January, 1913.

The M Company was incorporated about January —, 1913. It immediately acquired the patents, assets, and business of the O Company, and of the P Company, and of one A. The O Company was, prior to that time, engaged in manufacturing an automobile fixture and owned certain patents relating to the same. A, prior to 1913, was also the owner of a number of patents relating to the manufacture of a similar fixture. He had given an exclusive license to the P Company under these patents and that company likewise owned some patents relating to and was in the business of manufacturing and selling the same kind of fixtures. Just prior to the organization of the M Company, the O Company, on the one hand, and A together with the P Company on the other, were in serious patent litigation. Countersuits had been brought for infringement and it is stated that under such conditions the business of each of the corporations was being seriously injured. In fact, patent counsel advised at the time that the pending litigation might not only but probably would result in absolute destruction of the particular business by virtue of the fact that each of the litigants could not only prevent the other from manufacturing the fixtures which they then manufactured, but there was then no known method by which commercially satisfactory fixtures could be manufactured without uniting in one owner the patents in controversy. It was thereupon determined that the M Company be organized with an authorized capital stock of 220x dollars, made up as follows:

Y shares of preferred stock of the par value of 5z dollars each and 10y shares of common stock of the par value of 5z dollars each, making a total capitalization of 220x dollars. All of this stock was immediately issued in consideration of the acquisition by the corporation of the patents and other assets of the O Company and of the patents and other assets of the P Company and all of the patents of A with respect to which he had previously given exclusive licenses to the P Company. Inventories made at the time show that



cash and other tangible property acquired by the M Company were of the value of 37 1-5x dollars. The tangible assets to the amount thus determined were accordingly entered on the books of the new corporation, and all of the rest of the capital stock in excess of the par value of this amount, or 182x dollars, was entered upon the books of the corporation under the asset "patents, trade names, trade-marks and good will." The corporation, however, subsequently claimed that the value of its patents was really in excess of this amount and for the purpose of taxation reported this asset at a value of 182 1-5x dollars.

The Income Tax Unit, as a result of an examination of the taxpayer's books, determined that the value of patents, trade names, trade-marks, good will, etc., should have been stated as follows:

	Dollars
On basis of excess of par value of stock over tangible assets acquired by the corporation.....	182x
The value of patents on the books of the P Company when acquired by the corporation.....	1-50x
The value of patents on the books of the O Company when acquired by the corporation.....	1-2x
Total.....	182 13/25x
Less credits.....	1 1/5x
Total.....	181 8/25x

The corporation has accepted these figures, but contends they exclusively represent the value of patents acquired at date of organization, namely, January —, 1913. The Income Tax Unit arbitrarily reached the conclusion that this amount should be allocated on a basis of 50 per cent for the value of patents and 50 per cent for the value of good will, trade names, etc. This conclusion resulted in an exclusion from invested capital of the appellant at the beginning of the taxable year 1917 of 50x dollars.

Argument was made before the Committee to show, on the facts above stated, that the organization of the M Company was determined upon solely because of the value and protection of the patents owned by its predecessor companies and by A; that the value of these patents at that time was determined by the earnings of the corporations for a period of years prior to January 1, 1913, and that since January, 1913, the reorganized company has continued to demonstrate the value of these patents by its earnings resulting in an earned surplus of something over 80x dollars at December 31, 1917, after the consistent payment of dividends on the entire issue of preferred and common stock.

It is stated that prior to January 1, 1918, the company was engaged exclusively in the manufacture of the fixtures under these patents and that at the present time at least 70 per cent of all of the fixtures in use in this country are under the M Company patents.

The Income Tax Unit, in support of its position in allocating 50 per cent of the adjusted capital stock issued in excess of net tangible assets to good will, trade names, etc., refers to this Committee's Memorandum 34 (C. B. 2, p. 31). After deducting 10 per cent of the net tangible assets of the P Company and the O Company to cover earnings from such assets, the Unit attributed the remaining earnings to patents, good will, etc., which, capitalized on basis of five years' purchase, resulted in a value of 60x dollars. It must be borne in mind, however, that the Committee's recommendation above referred to dealt exclusively with such intangible assets as good will, trade-marks, trade brands, etc. Patents, under the 1917 law, had a somewhat different status.

The taxpayer has submitted the earnings for the years 1909 to 1912, inclusive, for the P Company and the average earnings for these years amounted to  $13x$  dollars, while the average invested capital for the same years was  $3\frac{1}{2}x$  dollars. This would indicate that the corporation earned more than \$3.71 for every dollar of capital employed in the business. There were no intangible assets on the books of this company and the only asset in the nature of an intangible was patents at  $1/50x$  dollars. Accordingly, the taxpayer submits that out of a return of 371.4 per cent on the average invested capital of P Company, 9 per cent of this return may reasonably be considered a manufacturing profit, although, as above stated, it manufactured no other commodities except the patented fixtures. It further claims that the balance of this percentage return of 371.4 per cent on this average invested capital should be assigned to patent earnings and the earnings so determined should be capitalized on basis of 6 per cent in order to arrive at the value of the patents acquired by M Company from P Company.

Similar calculations are made on the average capital and yearly earnings of the O Company, but the period is necessarily limited to two years prior to the organization of the M Company. There were no intangibles on the books of O Company and the only asset in nature of an intangible was patents at  $\frac{1}{2}x$  dollars. In this case the return on average invested capital is 17.25 per cent, and it is claimed that 8.25 per cent of the same should be applied to the average invested capital of the O Company on account of patent earnings. This amount of earnings it has also capitalized on a 6 per cent basis to determine the value of patents acquired from the O Company. In the instant case the Committee recognizes that 9 per cent is a fair return on average invested capital for manufacturing profit when there stand behind the invested capital substantially only tangible assets and the nature of the business is exclusively the production of patented articles. It can not, however, give sanction, in the instant case, to the capitalization of patent earnings on basis of 6 per cent when apportioned as above stated. It considers that a capitalization on basis of 10 per cent gives recognition to the value of the patents as indicated not only by the earnings of the companies prior to the reorganization of January, 1913, but also subsequent thereto. The Committee also has in mind the emphasis which was placed on the value of the patents when the two predecessor companies were in litigation. The Committee can not, however, ignore the fact that the trade names used on the patents of the predecessor companies had a good will or trade-mark value. This was recognized by the corporation in the trade name. Accordingly, using the average invested capital and the average earnings as submitted by the taxpayer for the years prior to organization of the M Company (these figures being subject to verification by the Unit), the Committee finds the value of the patents of P Company to be  $133\frac{8}{25}x$  dollars and the value of the patents acquired from the O Company to be  $11x$  dollars or a total valuation for the patents acquired by the M Company of  $144\frac{8}{25}x$  dollars in lieu of the value of  $181\frac{8}{25}x$  dollars, as claimed by the taxpayer. The difference,  $37\frac{1}{5}x$  dollars, fairly covers the value of the good will, trade-marks, etc., acquired by the M Company at the date of organization. This value of  $37\frac{1}{5}x$  dollars applicable to good will, trade-marks, etc., is, however, within the 20 per cent limitation prescribed by the statute for the inclusion of good will in invested capital. This, therefore, gives the M Company its full claim of  $181\frac{8}{25}x$  dollars for invested capital but not without due recognition on a sound basis of the value of the patents acquired from its predecessor companies.



In the consideration of the second exception taken by the appellant, to the effect that the Unit was in error in refusing to allow depreciation on patents for the year 1918, it is noted the following entries were made on the books of the corporation before they were closed for the taxable year ended December 31, 1918:

December 31, 1918.		Dollars	Dollars
Good will.....	10 7/10x		
To surplus.....			10 7/10x
To set up on books as of Dec. 31, 1918, a value for good will arising from advertising, ownership of patents, etc., in a sum equal to 1/17 of the book value of patents as at Dec. 31, 1917.			
This entry is made per instructions of president.			
Amortization of patents.....	10 7/10x		
To reserve for amortization of patents.....			10 7/10x
To set up on books as at Dec. 31, 1918, a reserve for the amortization of patents equal to 1/17 of the book value of these assets as shown by books Dec. 31, 1917, to wit, $182\frac{1}{4}x$ dollars $\times$ $1/17 = 10\frac{7}{10}x$ dollars.			
This entry is made per instructions of president.			
Surplus.....	10 7/10x		
To amortization of patents.....			10 7/10x
To close the latter account into surplus.			

The last entry above noted closes a nominal account (amortization of patents) into surplus without carrying the entry through the profit and loss account. Because the entry was made against surplus the corporation admits that its books do not show a deduction from income for amortization of patents. The Committee considers this merely a technical question of book-keeping and that the explanatory entries in journalizing these accounts clearly show the true intent of the corporation to amortize its patents on basis of 1/17 of the value as shown by the books at December 31, 1917, to wit,  $182\frac{1}{4}x$  dollars. It has been pointed out and confirmed that the item of good will is nothing more than an item of appreciation, and the taxpayer accordingly deducted under Schedule G in its 1919 tax return the surplus item of  $10\frac{1}{2}x$  dollars as an unallowable surplus adjustment of the prior year for invested capital purposes. The amount of allowable amortization must be adjusted to conform with the valuation of patents as determined by the Committee in this recommendation. With respect to the adjustment for prior years affecting invested capital at the beginning of the taxable year 1918, attention is directed to the following provision in article 843 of Regulations 45:

It can not be said that the correct computation of surplus and undivided profits necessarily requires a deduction in respect of the expiration of patents. It follows, therefore, that where a corporation in the exercise of its option has not written down the cost of patents, it is not ordinarily necessary to reduce the surplus and undivided profits in computing invested capital, whether the patents have been acquired for stock or shares or for cash or other tangible property. Due consideration will be given to the facts in any case in which this rule seems obviously unreasonable.

Article 167 of Regulations 45 reads, in part, as follows:

The fact that depreciation has not been taken in prior years does not entitle the taxpayer to deduct in any taxable year a greater amount for depreciation than would otherwise be allowable.

It is, therefore, clear that the corporation was within the provisions of the regulations in claiming amortization for the taxable year 1918 under article 167 without reducing its surplus at the beginning of the taxable year.

In consideration of the third exception taken by the appellant, to the effect that the Unit was in error in refusing to take into consideration (in

determining the value of intangible assets for purposes of invested capital) the proper value of the preferred stock originally issued and aggregating 20% dollars, it is noted that prior to January 1, 1917, the entire issue of preferred stock had been purchased by the corporation and was held in its treasury. It was so held until the company amended its charter in the year 1919, at which time the stock was canceled. In the computation for the allowance of intangibles, as prescribed by section 207 (a) of the Revenue Act of 1917 and section 326(a)4 of the Revenue Act of 1918, the Unit declined to take into consideration this preferred stock.

Section 207(a) of the Revenue Act of 1917 provides, in part, as follows:

\* \* \* Good will, trade-marks, trade brands, franchise of a corporation \* \* \* or other intangible property, bona fide purchases, \* \* \* for and with shares in the capital stock of a corporation \* \* \* in an amount not to exceed \* \* \* 20 per centum \* \* \* of the total shares of the capital stock of the corporation, shall be included in invested capital \* \* \*.

Article 57 of Regulations 41 prescribes the limitation to be:

Twenty per cent of the par value of the total stock or shares outstanding on that date (Mar. 3, 1917).

Section 326(a)4 of the Revenue Act of 1918 reads as follows:

Intangible property bona fide paid in for stock or shares prior to March 3, 1917, in an amount not exceeding (a) the actual cash value of such property at the time paid in, (b) the par value of the stock or shares issued therefor, or (c) in the aggregate of 25 per centum of the par value of the total stock or shares of the corporation outstanding on March 3, 1917, whichever is lowest.

In an informal opinion the Solicitor of Internal Revenue has held:

The company's contention is that by the purchase the stock in question became treasury stock and as such it was an asset, in that the company might have at any time sold the same for a consideration. Treasury stock as generally defined in the decided cases has usually been held to mean such portion of the shares of capital stock originally issued in consideration of property or cash contributed to the corporation as have been returned to the corporation by way of a gift or a loan in order to enable the corporation to raise working capital with which to operate. Having once been issued as paid-up shares, such stock, when returned to the corporation after it has been issued in the manner specified, becomes a part of the general assets of the company and may be sold or disposed of in the same manner as other personal property. The essential feature is, however, that it is paid-up stock, which by its transfer back to the corporation has not been changed in character. With reference to stock it may be said that the same object could be attained in the usual case by the sale by the stockholder of such shares and thereafter turning over to the corporation the proceeds of such sale. The original number of shares of stock issued in such a case remains constant and the capital stock liability of the corporation likewise remains the same. (*Crosby v. Stratton*, 17 Colo. Appeals, 212; 68 Pac., 130, 133; *Machey v. Burns et al.*, 16 Colo. Appeals, 6; 64 Pac., 485, 490; *Enright v. Heckscher*, 240 Fed., 863, 874; *Davies v. Ball*, 64 Wash., 292; 116 Pac., 83; *Camden Land Company v. Lewis*, 63 Atl., 523; *Davis v. Montgomery Furnace & Chemical Company*, 101 Ala., 127; 8 So., 496, 497; *Mosher v. Sinnott*, 20 Colo. Appeals, 454; 79 Pac., 742.)

It will be seen that the above definition can not include a corporation's own stock which it has purchased from its stockholders in the open market for the simple reason that whatever the corporation pays to the stockholder for his share of stock is a withdrawal by such stockholder of the amount of capital originally contributed to the capital stock of the company. By such withdrawal the share which his interest represented is extinguished because it has been so withdrawn. The amount of capital originally contributed still in the hands of the corporation constitutes the remaining capital stock, of which it can not be said that the interest formerly represented by the share of the withdrawing stockholder is a part. In considering a case very similar to the present one, the Supreme Court of Louisiana, in *Belknap v. Adams* (49 La. Annual, 1350; 22 So., 382, 383), said:

But, instead of a division of property, we have in this case the division of purchased stock, which, by the purchase, was canceled and remained canceled for all purposes until reissued. (1 Mor. Priv. Corp., secs. 112, 114; *Cook, Corp.*, sec. 282.) This is the well-defined result when the corporation purchases its stock. The purchase is an unauthorized use of the corporate funds, but, when permitted to stand or is unassailed, the purchase simply extinguishes the stock, increases the rights of the remaining stockholders. This division or donation of the purchased stock was not, in any sense, a distribution of corporate property.



In *Steel v. Farmers & Merchants Mutual Telephone Association* (Supreme Court, Kansas, May 8, 1915; 148 Pac., 661) the court said:

The use of the means or assets of a corporation to buy up its own capital stock permits the withdrawal of a stockholder without substituting another in its place, *repays to the withdrawing member his share of the capital, reduces the amount of the fund contributed to the common venture*, and to that extent injures the continuing stockholders and creditors and opens the door to mismanagement and unfairness.

See also *Bank v. Fox* (Federal case 2683), wherein the court speaks of the purchase by a corporation of its own stock as being an extinguishment of such stock.

In any view of the case, this is the logical legal result of the purchase by a corporation of outstanding shares of its own capital stock, for it is but returning to the stockholder the original contribution advanced by him and for which advance he was entitled to an interest in the capital stock of the corporation represented by his share of stock. This also appears to be the correct view from the standpoint of accounting principles. Dickinson, "Accounting, Practice and Procedure," at page 130, says:

An important question arises as to the treatment of stock of a corporation held in its own treasury. Many corporations still treat this as an investment asset, either under a special division of the balance sheet or among the current assets.

\* \* \* A little consideration will show that such a practice is entirely erroneous and misleading, and, moreover, that it also raises difficult questions of valuation. The capital stock represents the manner in which its property and assets are distributed among those who constitute the corporation. If one of these owners disposes of his share of the corporation, *he withdraws therefrom taking with him what he considers his fair proportion of the asset value, and leaving the rest to be divided among the remaining owners*. Assuming that the seller gets full value, the value remaining to the others is neither more nor less in fact than it was before, although if the stock is actually worth more or less than its par value, there will be an apparent profit or loss on the transaction: the effect of which may be thus illustrated: A corporation has a capital stock of \$1,000,000, divided into 10,000 shares of \$100 each, and represented by assets of equal value. The holders of 1,000 shares withdraw, i. e., sell their shares to the company at the book value, which in this case is par. *The stock is thereby reduced to 9,000 shares, i. e., \$900,000, and the assets are similarly reduced by the payment of \$100,000 to \$900,000. There is clearly no reason whatever for pretending that there are still 10,000 shareholders and assets of \$1,000,000, when as a matter of fact there are only 9,000 with assets of \$900,000, and the position of those 9,000 is entirely unchanged.*

On page 132 of Dickinson, "Accounting, Practice and Procedure," the author continues as follows:

As a matter of convenience small amounts of such stock are carried as marketable investments when the same are held temporarily; but even this practice is open to criticism as lending itself to a use of the funds of a corporation for influencing the market in its own stock, which is not one of the purposes for which it is permitted to exist.

See also Montgomery, "Income Tax Procedure, 1921," page 386.

In the instant case it appears quite clearly that this corporation did not purchase this stock for temporary purposes, but that such purchase was actually a part of a scheme to retire such stock in a general plan to rearrange the stockholdings in the corporation. The purchase was a retirement of the stock for all purposes. It is immaterial for our purposes that the corporation was required to pay taxes to the State upon the basis of the original capitalization (as they state in their brief they were required to do), for such payment may have been required by the State because of failure on the part of the corporation to give proper notice of the reduction in its capital stock as provided for by the State statutes. At any rate, it is not a point of importance in this case.

In view of the above, it is the opinion of this office that the action of the Income Tax Unit in refusing to recognize the preferred stock so purchased by the corporation for the purposes of its computation with respect to the allowance of intangibles for invested capital purposes was correct.

In this opinion the Committee concurs.

In consideration of the fourth exception taken by the appellant, to the effect that the Unit was in error in refusing to allow the right to correct the value of its inventory at December 31, 1918, it is noted that certain products were included in its inventory of December 31, 1918, priced at the market as of January 22, 1919, as quoted by the market report, the first market quotations after the Government's release of control of prices for these products. This adjustment decreased the profits for 1918 in the sum of  $x$  dollars. It is admitted by the taxpayer that the prices so fixed did not cover the entire

stock on hand at December 31, 1918. In view of this appellant's contention that it suffered an inventory loss under section 234(a)14 of the Revenue Act of 1918 can not be sustained. The Advisory Tax Board, in passing opinion July 24 in its Memorandum 52 (C. B. 1, p. 155), gave reference to article 267 of Regulations 45, which provides, *inter alia*, that:

Not later than 30 days after the close of the taxable year 1919 a taxpayer who has filed either a claim in abatement or a claim for refund, or both, shall submit to the Commissioner a descriptive statement showing the quantity and kind of all goods included in the 1918 inventory which have been (a) sold at a loss in the taxable year 1919, (b) sold at a profit during the taxable year 1919, or (c) not sold or otherwise disposed of during the taxable year 1919 \* \* \*.

Commenting on these provisions, the Advisory Tax Board said:

The regulations thus clearly require a statement showing the disposition of all the inventory, and the regulations conform to the statute which speaks of the inventory. An inventory is a well-understood concept and where the term is used without qualification it means the inventory as a whole, and not merely some part of the goods included in the inventory. The Advisory Tax Board is, therefore, of the opinion that an inventory loss can not be proved by a submission of evidence showing that a loss has been sustained in respect of a part of the inventory, without showing at least that the amount of the loss for which claim has been filed has not been offset by profits made on the remainder of the inventory.

If, therefore, a claim can only be sustained on basis of net loss in the inventory of the appellant, the adjustment which the taxpayer made in the inventory as of December 31, 1918, can not be sustained, because it does not reflect a net loss. The opinion of the Advisory Tax Board has been confirmed by this Committee in its Recommendation 487 (C. B. 4, p. 205), dated March 1, 1921.

The fifth and sixth exceptions taken by the appellant are to the effect that for the purpose of computing prewar income and invested capital the earnings of A from royalties on patents must be included and that under section 330 the value of patents as used in the computation of invested capital for the taxable year must be included in prewar invested capital in the same amount. It is noted that A, in 1906, gave the P Company the exclusive right to use his patents subject to the payment to him of certain royalties. These royalties were regularly paid him by the company, such payments constituting a deduction from the income of the P Company. The cost to A of procuring and developing the original patents is not in evidence.

The M Company acquired, on the date of its organization—

- (a) The assets of the O Company;
- (b) The assets of the P Company; and
- (c) The business of A in so far as it related to owning and licensing patents to the P Company.

In the computation of prewar income and invested capital the Income Tax Unit did not take into consideration the income or the invested capital of A as owner of a portion of the patents acquired. The Unit, however, in submitting the case for consideration by this Committee, gives approval under section 330 of the Revenue Act of 1918 to the claim of the appellant, but makes the point that under article 934 of Regulations 45 the excess of the valuation of any asset in existence during both the taxable year and any prewar year, but included in invested capital for the prewar year at a lesser value than for the taxable year, shall not be included in determining the difference, 10 per cent of which is added to or deducted from the war profits credit.

The Committee concurs in this conclusion and considers that the excess value of patents for the taxable year over the value at which they were carried on the books of the predecessor corporations and A should be eliminated for



computation of the increase in invested capital for the war profits credit. It is not considered that the income of A from royalties on patents can be capitalized to determine the invested capital of A for the prewar period.

Summing up, the Committee recommends:

1. That, in the appeal of the M Company, the value of patents acquired by said company at date of organization be placed at  $144\frac{1}{2}x$  dollars and the value of good will, trade-marks, etc., be placed at  $37\frac{1}{5}x$  dollars (these figures being subject to verification by the Unit under the principles of valuation herein stated).

2. That the corporation be allowed to amortize its patents in the taxable year 1918 on basis of one-seventeenth of the value recommended herein.

3. That the preferred stock purchased by the corporation and held as treasury stock be excluded in determining the statutory limitation on intangibles for purposes of invested capital.

4. That the corporation be denied its inventory adjustment at December 31, 1918, because net inventory loss has not been established.

5. That the corporation be allowed the value of patents of A in the computation of prewar invested capital in accordance with provisions of section 330 of the Revenue Act of 1918 and article 934 of Regulations 45.

6. That the corporation be allowed income from royalties on patents owned by A in computing prewar income in accordance with the provisions of section 330 of the Act.

3

II ('23)-16-1004: I. T. 1736

### Revenue Acts of 1917, 1918, and 1921.

A corporation purchased its own stock with its own bonds for a price fixed by the parties, which was in excess of the par value of the stock. The difference between the par value of the stock and the face value of the bonds does not represent bond discount.

In 1914 a corporation bought shares of its own stock at 263 per cent of their par value, and issued bonds in payment for the same together with a small cash payment. The taxpayer contended that the bonds were issued at a discount representing the difference between the par value of the stock and the face value of the bonds, and that this bond discount should be set up as an asset, and that the loss represented by such discount should be realized through the income account by a deduction from income each year in an amount determined upon the basis of the life of the bonds. The taxpayer argued that since the bond discount could be amortized over the life of the bonds, this amount represented an asset until it was written off by deductions from the income account.

Held, that the transaction in question had the effect of reducing the invested capital of the taxpayer to the extent of the face value of the bonds, and that this amount should be deducted in determining invested capital for 1917 and subsequent years. The difference between the par value of the stock and the face value of the bonds issued in payment for the stock did not represent bond discount. The price paid for the stock represented its fair market value as fixed by the parties to the contract, and the bonds accordingly were issued for a value which was received by the corporation as a loan. No deduction from income on account of bond amortization can be made by the corporation.

4





**Section 326.**—Invested Capital (§555).

**Article 869.**—Affiliated Corporations: Invested Capital for Prewar Period.  
(§828).

(See 12-21-1526; sec. 320, art. 802.) Basis for determining average prewar income and invested capital.

1





**Law Section 326.—Invested Capital (1918 Act—¶555, ante): (1921 Act—¶1035, post).**

**Art. 870.—Insurance Companies (Reg. 45—¶829, ante): (Art. 869 of Reg. 62—¶1241, post).**

II-(23)-23-1089: A. R. R. 3202.

### Revenue Act of 1917.

The reserve funds of life insurance companies, the net additions to which are deductible from gross income under section 12(a) of the statute, can not be included in computing invested capital.

The Committee has had under consideration the appeal of the M Company from the action of the Income Tax Unit in treating as a liability, in the computation of statutory capital for 1917, the amount of  $x$  dollars set up as a legal reserve as at December 31, 1913.

Prior to January 1, 1913, the appellant operated under regulations of the State of S applying to fraternal beneficiary associations, which were not required to set up reserves for protection of policyholders. Pursuant to the provisions of a statute enacted by the State of S Legislature in 1912, the taxpayer since January 1, 1913, has operated on the mutual plan, and as at December 31, 1913, in accordance with the requirements of the State of S statutes, passed to a legal reserve  $1.31x$  dollars, of which  $x$  dollars represented surplus accumulated as at December 31, 1912, and  $.31x$  dollars, the net addition thereto for the year 1913. As at January 1, 1917, the total amount of  $x$  dollars (together with additions thereto taken as deductions in the computation of net income for respective years) appears to have stood as a part of the required legal reserve of the company. The taxpayer writes industrial life and sick benefit insurance, and accordingly is within the purview of article 870 of Regulations 45, as amended by T. D. 3153 (C. B. 4, p. 398). Article 870 as so amended provides in part that:

The reserve funds of life insurance companies, the net additions to which are deductible from gross income under the provisions of section 234 of the statute, can not be included in computing invested capital.

Section 12(a) second allows, in the case of insurance companies, a deduction for the net addition, if any, required by law to be made within the year to reserve funds. This provision is similar to the provisions of section 234(a) 10 of the Revenue Act of 1918, so that the rule announced in article 870 is applicable to 1917.

There is no question that the reserve created as at the end of 1913 and maintained during 1917 was a legal reserve, the net additions to which are deductible from gross income under the provisions of the Revenue Act of 1916, as amended, and the total amount of such legal reserve so comprised as at January 1, 1917, must be treated as a liability of the taxpayer in the computation of the statutory capital, in accordance with article 870 of Regulations 45 and paragraph 11 of Bulletin "H," covering rulings peculiar to insurance companies.

The Committee accordingly recommends that the action of the Income Tax Unit be sustained and the appeal denied.

KINGMAN BREWSTER,  
*Chairman Committee on Appeals and Review.*





**Section 326.—Invested Capital** (1918 Act—¶555, ante): (1921 Act—¶1035, post).

**Article 871.—Foreign corporations** (Reg. 45—¶830, ante): (Reg. 62—¶1242, post).

9-21-1486: A. R. R. 397.

### REVENUE ACT OF 1917.

The M Company, a foreign manufacturing corporation, is said to be in reality no more than a branch of the N Company, a very much larger foreign corporation. The facts with regard to the corporate organization and business of the taxpayer and the parent corporation are shown in the record to be as follows:

The parent corporation was organized about 1877 to take over the business established many years ago and continuously conducted by members of an English family. This corporation has, on a very large scale, continued down to the present time the manufacture and sale of the goods and had outstanding, in 1917, ordinary shares of the par value of 66 $\times$  pounds, which had then a market value of 297 $\times$  pounds, or nearly 1,450 $\times$  dollars.

The parent company and its subsidiaries then, as they do now, manufactured and marketed this product in many parts of the world.

Previous to 1901, the parent company had sold its products in the United States through an agent; but, in or about that year, the company established its own agency in this country and continued to sell its products through that agency down to 1908.

In the year 1908, the company purchased a factory in this country, and then began the manufacture of its goods in this country. Late in 1907 it was found desirable to organize a new English corporation which should carry on the American business of the company. Accordingly, the M Company, this taxpayer, was organized under the English Companies Act with an issued capital of  $\times$  pounds, equivalent in dollars at \$4.86 in the pound to 4.86 $\times$  dollars, and the new company immediately took over the parent company's plant and entire assets in this country. The amount of this capitalization is said to have been approximately equivalent to the net income from the American business for one year at that time, and it is asserted and insisted upon that such capitalization bore absolutely no relation whatever to the value of the assets acquired by the new company, "for (so asserts the taxpayer's brief) in these assets were included, at a nominal valuation, the trade-marks and good will of the parent company, which had a real value of say 100 $\times$  dollars."

It is further asserted that the entire capital stock of the taxpayer which, ever since 1908, has nominally carried on the American business, is and always has been owned by the parent company.

It is said that the majority of the board of directors of taxpayer company are all members of the said English family, as are the directors of the parent corporation, and the entire net income from the operations of the business goes into the treasury of the parent company, no appreciable portion of such income being retained for any considerable period of time in the treasury of the taxpayer; and that the taxpayer is only able to carry on its business and finance itself, without accumulating a surplus, because it can depend upon the vast resources of the parent company.

In filing its income and excess profits tax return for the taxable year ended November 30, 1917, the taxpayer, in its excess profits tax return, set forth that the income for that year was 10 $\frac{1}{2}$  $\times$  dollars, which was subsequently amended and fixed by the Commissioner of Internal Revenue at 10 $\times$  dollars.

In this return it was suggested to the Department by the taxpayer that a fair constructed capital should be fixed after giving due weight to the foreign invested capital and taking into account the very great value of the foreign trade marks; a transfer of which, so far as they were used in America, had been made to the taxpayer in 1908 at the time of its incorporation.

In May, 1918, the taxpayer was notified by the Commissioner, of a tax of  $1\frac{1}{2}x$  dollars; which was promptly paid and nothing further was heard by the taxpayer from the Government until March 8, 1920, when the company was notified of the proposed assessment of an additional tax in the sum of  $2\frac{1}{2}x$  dollars. In arriving at this additional tax, the Income Tax Unit recognized that the assessment should be made under section 210 of the Revenue Act of 1917 and gave to the taxpayer a total constructed capital of  $28x$  dollars, being an additional allowance of approximately  $10x$  dollars above the invested capital as shown by the books of the taxpayer; and it is from this action on the part of the Unit that the taxpayer now appeals.

It is the understanding of this Committee that there is no controversy as to the correctness of the facts substantially as advanced by the taxpayer in his brief submitted upon appeal to the Committee, and which are set forth above.

It is the contention of the taxpayer that no fair comparison can be made for the purpose of computing the tax under section 210 of the Revenue Act of 1917, except with the parent corporation, and the taxpayer prays that under such circumstances it should be assessed under that section on the same basis on which it would be assessed if it were a branch of the parent company; or, if not on that basis, then directly as a branch of the parent company, and that an estimate of the capital of the parent company employed in this country be made under article 48 of Regulations 41 relative to the war excess profits tax imposed by the War Revenue Act approved October 3, 1917.

This case is unique, at least in the experience of the Committee, in that the taxpayer is a foreign corporation, of which the entire business is transacted and the profits therefrom earned in the United States, and in that it is also a subsidiary of another foreign corporation which owns or controls all of the taxpayers' capital stock.

A situation is here presented which does not seem to have been contemplated or exactly provided for by the framers of the Act. Nevertheless, the Committee finds no warrant in the law or regulations which would permit or justify the disposition of the case which is sought by the taxpayer; nor is it all certain that such consideration, if possible, would afford to the taxpayer any further relief than that which has heretofore been granted to it by the Commissioner, acting through the Unit.

Treasury Decision 2662 reads in part as follows:

Pursuant to article 78 of Regulations 41, relative to war excess profits tax, affiliated corporations as limited and defined in paragraphs C and D below are hereby directed to make consolidated returns for the purpose of excess profits tax. Affiliated corporations other than those falling within the provisions of paragraphs C and D may make a consolidated return only after having secured permission in writing from the Commissioner of Internal Revenue.

The Treasury decision then proceeds to quote article 77 of the regulations in definition of "affiliated corporations," and in paragraphs A to H enlarges upon the definition contained in that article of the regulations.

It seems unnecessary to refer more in detail, either to this Treasury decision or to articles 77 and 78 of Regulations 41, for the reason that, as has already been said, the instant case presents a feature apparently not contemplated or provided for in either the law or the regulation, namely,



that both the taxpayer and its parent company are foreign corporations, while the taxpayer alone does business within the United States.

It has been consistently held by the Department that the privilege of filing a consolidated return can not be granted to a taxpayer in cases where the Department would be without power to require such a return. Clearly this is such a case, for it is obvious that the Department has no such authority in the case of the two foreign corporations.

It would seem, therefore, that the request of the taxpayer for the privilege of filing such a consolidated return must be denied, if upon no other ground than the sufficient one that the Department is entirely without power to grant such a privilege. But it is doubtful, even though the Department had the power, and the privilege were granted, that the taxpayer would experience the anticipated relief, for it seems to the Committee that the application by the Unit to this case of section 210 of the Revenue Act of 1917 produces substantially the situation that the taxpayer seeks to attain, through article 48 of Regulations 41, which provides that:

When used in reference to a foreign corporation or partnership, or a nonresident alien individual, the term "invested capital" means that portion of the entire invested capital as defined and limited by these regulations which the net income from sources within the United States is of the entire net income.

This is substantially the condition produced by the application of section 210 to the taxpayer's case under consideration, and it does not appear to the Committee, therefore, that any further relief can be granted to the taxpayer than has already been afforded by the Unit; nor, as a matter of fact, that any hardship or injustice has been done to the taxpayer by such application, since the taxpayer's earnings, based on its actual investment, were 215 per cent, and its excess profits tax, computed under the provisions of section 210, is 38.25 per cent of its net income.

San Francisco, California

Dear Sir,  
I have the honor to acknowledge the receipt of your letter of the 10th inst. in relation to the proposed sale of the property of the late John A. Sutter, and in reply to inform you that the same has been forwarded to the proper authorities for their consideration. I am, Sir, very respectfully,  
Yours, &c.

I have the honor to acknowledge the receipt of your letter of the 10th inst. in relation to the proposed sale of the property of the late John A. Sutter, and in reply to inform you that the same has been forwarded to the proper authorities for their consideration. I am, Sir, very respectfully,  
Yours, &c.

I have the honor to acknowledge the receipt of your letter of the 10th inst. in relation to the proposed sale of the property of the late John A. Sutter, and in reply to inform you that the same has been forwarded to the proper authorities for their consideration. I am, Sir, very respectfully,  
Yours, &c.

I have the honor to acknowledge the receipt of your letter of the 10th inst. in relation to the proposed sale of the property of the late John A. Sutter, and in reply to inform you that the same has been forwarded to the proper authorities for their consideration. I am, Sir, very respectfully,  
Yours, &c.

I have the honor to acknowledge the receipt of your letter of the 10th inst. in relation to the proposed sale of the property of the late John A. Sutter, and in reply to inform you that the same has been forwarded to the proper authorities for their consideration. I am, Sir, very respectfully,  
Yours, &c.



**Section 327.—Special Cases (1918 Act—¶565, ante): (1921 Act—¶1044, post).**

**Article 901.—Treatment of Special Cases (Reg. 45—¶831, ante): (Reg. 62—¶1243, post).**

1-19-119: T. B. M. 7.

The same principle stated in the Revenue Act of 1918 that assessment will not be made as a special case under section 328, when the tax is high “merely because the corporation earned within the taxable year a high rate of profit upon a normal invested capital” is applicable to the Revenue Act of 1917 in cases in which application is made for assessment under section 210 of that act.

1

14-19-441: T. B. M. 58.

This is an application by the X Company for assessment for the year 1917 under section 209 of the Revenue Act of 1917, or, if this application is denied, for assessment under section 210.

The corporation was engaged in a manufacturing business.

The application for assessment under section 209 should be denied. Under the definition of nominal capital contained in article 74 of Regulations 41 this is not a “case of a trade or business having no invested capital or not more than a nominal capital.” (See section 209.) It “belongs to a class which necessarily and customarily requires capital for its operation.” (See article 74.)

The application for assessment under section 210 should also be denied. It is true that the excess profits tax rate determined without the benefit of section 210 is very high, approximately 59 per cent, but the profits on the business were clearly war profits, and thus of a kind which were intended to be taxed at a high rate. The case does not come within any of the classes of exceptional cases enumerated in article 52 of Regulations 41 as within the scope of section 210. Obviously it is not within any of these classes unless it is within that:

(4) Where the invested capital is seriously disproportionate to the taxable income.

While the Regulations do not enumerate all the ways in which such cases may arise, this class of cases is limited to cases enumerated or those similar in character. The cases enumerated are those which arise through:

(a) The realization in one year of the earnings of capital unproductively invested through a period of years or of the fruits of activities antedating the taxable year; or,

(b) Inability to recognize or properly allow for amortization, obsolescence, or exceptional depreciation due to the present war, or to the necessity in connection with the present war of providing plant which will not be wanted for the purposes of the trade or business after the termination of the war.

The present case does not arise in either of these ways, or in any similar manner. Properly speaking, this is a case where taxable income is “high” with respect to invested capital rather than where invested capital is “seriously disproportionate” to such income. Section 210, as interpreted in the Regulations, like paragraph (d) of section 327 of the Revenue Act of 1918, was not intended to afford relief where the only reason therefor is a high rate of tax—that is, a high ratio of taxable income to invested capital. There must be in addition some abnormality with respect to invested capital, taxable income, or both. There is no such abnormality in the present case.

15-19-453: T. B. M. 53.

Recommendation in the case of the application of A, for assessment under section 210 [1917 Act]. Request denied.

The appeal in this case for assessment under section 210 is based upon the fact that A began to liquidate the business in 1917 and therefore had abnormal profits during that year. This is supported by argument to show that by reason of such liquidation there was a sacrifice of the value of trade brands and other intangibles which should receive consideration.

The record makes it doubtful whether there was any actual liquidation in 1917; but assuming that there was, it has been repeatedly held that a taxpayer who had liquidated all or part of his business in a particular year is not entitled to assessment under section 210, unless such liquidation results in throwing into a single year profits so abnormally high as to result in a tax which, compared with the taxes imposed upon representative business concerns in the same line of business, is seriously disproportionate and productive of exceptional hardship.

A comparison of the return of A with representative concerns in the same line of business discloses the fact that no material change in the tax would result by fixing his tax on the basis of the experience of such representative concerns. It further appears that the amount of the invested capital can be satisfactorily determined without special difficulty, and that under the conditions prevailing in 1917 the profits were not seriously disproportionate to such invested capital. With respect to the alleged liquidation or shrinkage in the value of intangible assets, there were in the year 1917 no facts or events affecting these intangibles sufficiently definite and conclusive to warrant special deductions either as extraordinary depreciation (including obsolescence) or loss. The case plainly does not come within the time limits controlling allowances for the obsolescence of intangible assets in the liquor business, laid down in Advisory Tax Board Recommendation No. 44. The Advisory Tax Board, therefore, recommends that the petition of the taxpayer be denied.

2

15-19-454: T. B. M. 60.

The limitation of the tax under the Revenue Act of 1918 on profits derived from the sale of a discovered mine can not be applied to the assessment of 1917 taxes, nor can such limitation or any modification thereof be used as a basis for an assessment under section 210 of the Revenue Act of 1917. A case in which income as compared with invested capital has been abnormally increased by the sale of all capital assets, may be considered under section 210, Revenue Act of 1917.

3

19-19-492: T. B. R. 58

*Ruling Under Revenue Act of 1917.*

The M Company appealed to the Advisory Tax Board to be taxed under section 209 of the act of October 3, 1917, and as a personal service corporation under the Revenue Act of 1918.

The facts appear to be as follows:

The M Company is a corporation engaged in the business of retailing,



and the return under consideration is for the fiscal year ended June 30, 1918. The stock of this corporation is owned by two stockholders who are actively engaged in the business and are the principal salesmen. There is but one other salesman employed by the corporation, and he works on a commission basis. The claim filed by this corporation sets forth the fact that the employment of capital is unnecessary in the business, except in paying for merchandise consigned to claimant by the factory and for the payment of the freight charges assessed thereon. The claim also shows how the direct use of the capital of the corporation can be avoided by having the purchaser make the customary deposit when placing his order and the funds thus secured would enable the corporation to transact business without the use of its own capital, no stock being carried other than that passing through the shop for test before delivery. The statements made by the corporation show that capital is necessary in the conduct of the business. The nature of the business is also well known and the statements made in the claim clearly establish the fact that the business conducted by this corporation is purely a commercial enterprise. Section 209 was not intended to apply to a commercial business, even though the capital used should be small in amount, and the definition of a personal-service corporation in section 200 of the Revenue Act of 1918 excludes any corporation 50 per cent or more of whose gross income consists of gains, profits, or income derived from trading as a principal.

Article 71 of Regulations No. 41 provides:

Section 209 \* \* \* applies primarily to occupations, professions, trades, and businesses engaged principally in rendering personal service in which the employment of capital is not necessary and the earnings of which are to be ascribed primarily to the activities of the owners.

While the business of the M Company is evidently commercial it is of a nature, however, wherein salesmanship largely governs the volume of business, and in this case the two stockholders are actively engaged as salesmen for the corporation; and, while the income of the corporation is derived from purchase and sale, the volume of business would appear to rest practically upon the individual efforts of the two stockholders.

The examination of a number of returns of similar concerns indicates that many of them belong in section 210 of the act of October 3, 1917, and section 328 of the Revenue Act of 1918. The data on which a recommendation with respect to assessment under sections 210 and 328 might be based was not transmitted to the Advisory Tax Board, but in numerous cases where a commercial business is dependent upon the personal efforts of the stockholders and but a nominal capital is used, assessment has been so made.

The Advisory Tax Board, therefore, recommends that the decision of the Income Tax Unit declining to consider the claim of the M Company for taxation for the year 1917 under section 209 of the act of October 3, 1917, and for the year 1918 as a personal-service corporation, be sustained, and that the return of the corporation be examined with the view of determining whether assessment should be made under sections 210 and 328 of the 1917 and 1918 Revenue Acts, respectively.

4

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(See 2-20-679; Section 326, Article 841.) Application of section 327, Revenue Act of 1918, in cases where good will has been built up by the expenditure of large sums in advertising.

5

5-20-722: A. R. R. 19.

The firm of A is engaged in the produce commission business, but a proportion of its income is derived from buying produce outright and selling it for its own account. This proportion, however, is entirely problematical and speculative.

The Committee finds difficulty in arriving at the facts in this case for the reason that it is apparent from the papers submitted that the books of the partnership are not kept with precision. Nevertheless from the balance sheets submitted by the firm and from its own statements it appears that it was in the enjoyment of a "substantial credit" in addition to the capital invested by the partners. It appears certain that the income of the firm was derived about evenly from commissions on sales of produce belonging to others and from profits on sales of produce purchased for its own account.

Under these circumstances the firm is not entitled to consideration under Section 209 of the Revenue Act of 1917.

Article 73 of Regulations 41 provides that—

Commission houses regularly employing a substantial amount of capital, whether to lend to principals or to carry goods on their own account, are not deemed to be agents or brokers and are taxable under the provisions of article 16.

Article 74 of the same regulations provides that—

The following will not be construed as businesses having a nominal capital for purposes of excess profits tax; (b) corporations which, although their capitalization is nominal, employ a substantial amount of capital in their business.

The Committee is of the opinion that the facts, so far as they are known or asserted by the taxpayer, construed in the light of the regulations above quoted, clearly exclude the taxpayer from whatever benefit might be derived from the application of section 209 of the Revenue Act of 1917, and therefore the Committee recommends that the appeal of the taxpayer for consideration under such section be denied and that the action of the Income Tax Unit in assessing tax under Section 210 of the above Act be approved and confirmed.

5

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(See 10-20-783; Section 311, Article 783.) Consideration of section 327 in connection with cases where the median (section 311(c)) is used in computing the war profits credit.

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6 (See 17-20-882; Section 326, Article 837.) Application of section 210, Revenue Act of 1917, and sections 327 and 328, Revenue Act of 1918, in cases where the principal asset of a corporation is an invention of unknown value.

7

19-20-927: O. 1000—A.

The provisions of section 327(d) of the Revenue Act of 1918 are applicable to cases of hardship caused by abnormal conditions affecting the capital or income of the corporation for the prewar period or for the taxable year.

A reconsideration of Law Opinion 1000, in which it is decided that the provisions of section 327 (d) of the Revenue Act of 1918 do not apply where hardship is caused by some abnormal condition affecting the capital or income



of the prewar period of the corporation, has been requested. Section 327(d) provides as follows:

(d) Where upon application by the corporation the Commissioner finds and so declares of record that the tax if determined without the benefit of this section would, owing to *abnormal conditions affecting the capital or income of the corporation*, work upon the corporation an exceptional hardship evidenced by gross disproportion between the tax computed without benefit of this section and the tax computed by reference to the representative corporations specified in section 328. This subdivision shall not apply to any case (1) in which the tax (computed without benefit of this section) is high merely because the corporation earned *within the taxable year* a high rate of profits upon a normal invested capital nor (2) in which 50 per cent or more of the gross income of the corporation *for the taxable year* (computed under section 233 of Title II) consist of gains, profits, commissions, or other income derived on a cost-plus basis from a Government contract or contracts made between April 6, 1917, and November 11, 1918, both dates inclusive.

This subdivision is not in terms limited in its application to cases arising out of abnormal conditions affecting the capital or income of the corporation *for the taxable year*. The words "capital or income of the corporation" are general words applicable to the income or capital of any year and can not be limited by construction unless there is a clear, necessary, and irresistible implication from other parts of the Act that such a limitation should be made. *Faw v. Marsletter*, 3 Cranch, 10, 23; *United States v. Coombs*, 12 Peters, 72, 80. Furthermore, in the same subdivision Congress has in two instances specified that the income or profits referred to is that of the taxable year, although the context made that meaning clear without specification. The use of such a limiting clause in two instances and the absence of it in the third instance indicates that the words were there used without limitation. Therefore, unless there is some clear and necessary inference from the other parts of the statute, it seems evident that subdivision (d) includes cases of hardship caused by abnormal conditions affecting the capital or income for the prewar period.

The prewar data is used in computing the war profits credit. Section 311 defines the war profits credit. It may consist of (a) \$3,000 plus the average net income for the prewar period with an adjustment for changes in capital; or (b) \$3,000 plus a percentage of the invested capital for the taxable year based on the median average established by the prewar experience of a general class of trade or business. This credit is used by concerns having no prewar history; or (c) a minimum war profits credit of \$3,000 plus 10 per cent of the invested capital for the taxable year.

It is suggested that because of the minimum war profits credit provided for in section 311(b) in case a corporation had no income in the prewar period or earned less than 10 per cent of its invested capital, it should be presumed that Congress intended to include in section 311 all relief which should be granted because of abnormal conditions existing in the prewar period, and that there is a clear and necessary inference that Congress did not intend to grant further relief of the same nature under section 327 on account of the same conditions.

It should be noted, however, that the relief granted in section 311 and that granted in section 327 are not of the same nature. Section 311 establishes certain rules applicable to general classes and which apply in all cases whether hardship actually exists or not. It gives relief to industries which passed through a period of depression in the prewar years. It also applies to concerns which earned less than 10 per cent in the prewar period, even though their tax is not grossly disproportionate to that of their competitors. Neither of these cases would be helped by section 327.

Section 327 on the other hand deals not with general classes but with specific instances and grants relief in special cases according to the facts of

each case where, without such relief, there would be a hardship as compared with representative concerns because of some abnormal condition affecting the capital or income of the corporation. The two sections are of a different nature. Section 311 would give no relief to a corporation belonging to a class which normally earned 20 per cent if that corporation, due to some abnormal condition affecting the income of the prewar period, earned only 12 per cent during the prewar period. Such concerns do not receive even partial relief under section 311. They would receive relief under section 327 if that applies. Section 311 lays down a number of general rules applicable to general classes which apply in all cases without reference to their effect. Section 327 deals with specific cases and applies only where the failure to give relief will cause hardship. These sections have different purposes, apply to different classes of cases, and measure the relief in a different way. In my opinion, the fact that they may both affect the same case does not make section 311 exclusive in that case.

It is concluded that the fact that the general rules established by section 311 will in some cases grant partial relief against an abnormally low income in the prewar period, does not clearly and necessarily limit the application of section 327 to cases of hardship arising out of abnormal conditions affecting the capital and income for the taxable year only. No other reason has been suggested for limiting the literal interpretation of the general words used in section 327(d). They should, therefore, be given their ordinary and natural meaning so that section 327(d) will apply to cases of hardship due to abnormal conditions affecting the capital and income of the prewar period or of the taxable year.

8

20-20-944: A. R. R. 104

## REVENUE ACT OF 1917.

During its fiscal year, which ended May 31, 1911, this corporation commenced the erection and operation of a refinery wherein the crude product manufactured by it could be refined and made into high-grade finished products, thus adding a new department to its business which had theretofore been confined to purchasing and manufacturing the raw material into the finished product as above outlined and selling the residue of the raw material.

The building of this additional plant and the experimental operation and development of this new line of business extended over several years, requiring the withdrawal from its other lines of business of a large share of the corporation's available capital, thus greatly curtailing its earning power and reducing its profits for these years in which this experimentation and development was in progress, and requiring, also, the investment of a considerable portion of its working capital, so withdrawn from its other lines of industry, in real estate, buildings, machinery, etc., and necessitating the spending of the remainder for supplies and accessories to the refinery business; and in advertising, and in other ways exploiting the particular trade brands adopted by this company for its finished product.

It is set forth in the corporation's brief that all of the capital thus required and so employed was, for the time being, unproductive; but that it was of necessity included on its books of account and in its annual statements as a part of its invested capital; that it not only earned nothing and thereby reduced the percentage of profit for the business as a whole; but for practically



all of the time designated as the "prewar period," this development and these expenses resulted in an actual loss in its refinery business.

In support of this contention the corporation submits a statement from which it appears that its earnings on the capital actually invested in its business, exclusive of the refinery, during the prewar period, were at the rate of 11.1 per cent of the capital so invested, and in addition it submits a statement of the annual earnings of its business as a whole from June 1, 1898, to May 31, 1918, which statement follows:

*Percentage of Earnings to Investment.*

Year ended May 31:	Per cent.	Year ended May 31:	Per cent.
1899.....	27.5	1909.....	40.6
1900.....	24.8	1910.....	16.4
1901.....	.....	1911.....	3.5
1902.....	61.9	1912.....	16.8
1903.....	48.7	1913.....	1.2
1904.....	21.7	1914.....	13.0
1905.....	22.2	1915.....	11.6
1906.....	23.2	1916.....	1.4
1907.....	21.9	1917.....	44.5
1908.....	19.6		

From this statement it appears that during the period to and inclusive of the year 1910 the earnings never fell below 16.4 per cent on its invested capital (except in the year 1901, when there was a loss) and ran as high as 61.9 per cent in 1902, the average for the 12 years being 26.1 per cent.

In computing the tax of this taxpayer for the year 1917, the Income Tax Unit applied the provisions of sections 203 and 205 of the Revenue Act of 1917 and established comparisons with corporations with capital between \$1,000,000 and \$1,500,000 which were engaged in a similar line of business. In this classification were found only three corporations beside the taxpayer, and the earnings of these were about 7 per cent of their invested capital. From this comparison by the Unit the taxpayer appeals on the ground that the corporations selected are not representative so far as its business is concerned, for the reason that none of them engages in all the different lines of activities which comprise the business of the taxpayer, and also on the ground that its own average earnings of 26.1 per cent over a period of 12 years prior to the prewar period and 44.5 per cent for its taxable year 1917 are more truly an indication of its earning power than can justly and equitably be arrived at by the use of the comparatives selected by the Unit.

Section 203 of the Revenue Act of 1917 provides:

That for the purpose of this title the deduction shall be as follows, except as otherwise in this title provided:

(a) In the case of a domestic corporation, the sum of (1) an amount equal to the same percentage of the invested capital for the taxable year which the average amount of the annual net income of the trade or business during the prewar period was of the invested capital for the prewar period (but not less than seven or more than nine per centum of the invested capital for the taxable year) \* \* \*

Section 205 provides:

(a) That if the Secretary of the Treasury, upon complaint, finds \* \* \* (2) that during the prewar period the percentage, which the net income was of the invested capital, was low as compared with the percentage, which the net income during such period of representative corporations, \* \* \* engaged in a like or similar trade or business, was of their invested capital, then the deduction shall be the sum of (1) an amount equal to the same percentage of its invested capital for the taxable year which the average deduction (determined in the same manner as provided in section two hundred and three, without including the \$3,000 or \$6,000 therein referred to) for such year of representative corporations \* \* \* engaged in a like or similar trade or business is of their average invested capital for such year plus (2) in the case of a domestic corporation \$3,000 \* \* \*.

In the enactment of these two sections of the law Congress assumed that the business of the three years immediately preceding the outbreak of the

war on August 1, 1914, would, in general, afford a reliable measure of the average normal business of the corporation; but in the instant case, the application of section 203 appears to work an injustice because this period (referred to in the law as the "prewar period") was, for this taxpayer, rendered abnormal and not a true measure of its normal average business, by reason of the fact that it was in this very period that it undertook the development of its business of refining in addition to the business theretofore conducted by it.

For the alternative consideration of this case under section 205, the Committee requested the Unit to furnish statistics covering a broader field than that represented by the three comparatives previously used, in view of the taxpayer's protest that these are not truly representative for the reason that, so far as it knows, it is the only corporation of this character which engages in the purchase of raw material direct and disposes of such material after the portion used for the finished product has been separated therefrom.

From the statistics presented by the Unit in compliance with this request, and which include 249 corporations capitalized at from \$10,000 to \$10,000,000 it appears that 103 of them had prewar earnings of 7 per cent, and 124 had prewar earnings between 8.80 per cent and 8.99 per cent—the average for the entire 249 corporations being 8.1 per cent.

The Committee is of the opinion that, under the circumstances, this broader field presents a truer basis of comparison than do the three companies whose capital is in the class with that of the taxpayer but whose business, according to the taxpayer, is much more limited in its scope.

In consideration of these facts and of the fact of this company's high rate of earnings prior to the year 1911 when it began the installation and development of the new branch of its business and that in the prewar period its earnings, exclusive of the loss on its capital invested in its refinery business then being developed, were 11.1 per cent, and of the fact that in the taxable year 1917 itself this company's earnings were 44.5 per cent of its invested capital, the Committee is of the opinion that this taxpayer, for the year 1917, is entitled to further relief than that heretofore granted to it by the Income Tax Unit, and that its deduction under sections 203 and 205 of the Revenue Act of 1917 should be computed at 8.1 per cent of its invested capital.

9

20-20-945: A. R. R. 110.

## REVENUE ACT OF 1917.

Recommended in re appeal of N Company, that its application for assessment under the provisions of section 210 of the Revenue Act of 1917 be granted.

The Committee on Appeals and Review has had under consideration the appeal of the N Company from a decision of the Income Tax Unit denying its application for assessment under the provisions of section 210 of the Revenue Act of 1917 and assessing the tax for that year under the provisions

It appears that this corporation was organized in 1909, with an authorized capital stock of 10x dollars fully paid in, of which 4x dollars is represented by cash and 6x dollars is represented by working models turned in by A, president of the corporation, for which he received stock in that amount. The corporation since the date of its organization has been engaged in the manufacture of machinery, and on January 1, 1917, it had an accumulated surplus of 85x dollars and capital stock of 10x dollars or a total capital as shown on the return for 1917 of 95x dollars.



The corporation has concurred in all the adjustments made by the Income Tax Unit with the exception of two. It protests against the failure on the part of the Unit to allow the addition to invested capital of an item of 30x dollars originally claimed on account of the patents, good will, and other assets, partly tangible and partly intangible, which were put into the corporation by one of its officers and stockholders at the time of organization and also against the disallowance of 15x dollars as a deduction in computing net income for 1917 set up as a reserve for cost of construction, etc. This reserve was set up on the books of the corporation to take care of the expense of installing machinery sold during the year 1917, but which had not been installed at the close of the year. It subsequently developed that the amount actually paid out for installation in 1918 and charged to this reserve was 10x dollars. This amount has been allowed to the corporation in office letter dated March 1, 1920. In this letter the corporation's application for assessment under the provisions of section 209 was denied and it was notified that its correct tax liability for 1917 was 24x dollars.

It is urged that it would have been impossible for the present company to have succeeded on the small capitalization had it not been for the other property, both tangible and intangible, put into the business by A for which he received no stock. It is further urged that at the time the corporation was organized no consideration was given to the fact that the property turned in by A, including the patterns valued at 6x dollars had a value largely in excess of the par value of the stock issued to A for the patterns alone. In this way it is urged that the corporation is penalized through not having issued capital stock for the full valuation of both the tangibles and intangibles paid into the corporation by A.

The record further discloses that at the time of dissolution of the M Company, the patterns which were given to A by that company and later turned over by him to the N Company were carried on the books of the M Company at a valuation of 16x dollars, and that the patents were also carried on its books at a valuation of 45x dollars. No part of the good will or the patents is represented in the capitalization of the present company. This, it is urged, entitles the corporation to consideration under the provisions of section 210 of the Revenue Act of 1917.

The excess profits tax of this corporation has been determined under the provisions of sections 201 and 207 at 48.58 per cent of the net income. The corporation, through its accountants, contends that this is due to the conservative accounting and low capitalization at the time of organization, and also to the fact that the corporation is denied in the computation of its invested capital amounts, such as patents, good will, etc., actually paid into the business and actually earning income for the corporation on which it is paying a tax.

The Committee has carefully considered the points at issue and the arguments made by the representatives of the corporation, and has reached the conclusion that this corporation has capital which is earning income but which can not be used in the computation of its invested capital for 1917 under the statutory provisions of section 207.

Article 52 of Regulations 41 provides among other things, that a claim for assessment under the provisions of section 210 may arise in cases where—  
long-established business concerns, which by reason of ultra-conservative accounting or the form and manner of their organization would, through the operation of section 207, be placed at a serious disadvantage in competing with representative concerns in a like or similar trade or business.

In view of the foregoing the Committee feels that this corporation

should be taxed under the provisions of section 210 and recommends that the decision of the Income Tax Unit be reversed for the reasons stated above.

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31-20-1111: A. R. R. 209.

REVENUE ACT OF 1917.

The Committee has had under consideration an appeal by the M Company against the constructive capital determined by the Income Tax Unit under the provisions of section 210, Revenue Act of 1917, claiming that the constructive capital determined by reference to representative concerns is not only less by a considerable amount than the invested capital claimed, but is also less than the invested capital which can be definitely established to the satisfaction of the Bureau.

The questions at issue as stated by the Unit in the letter of transmission are:

1. Has the department a right to fix the tax under section 210 without application by and against the wishes of the taxpayer?

2. Is the constructive capital determined by the Income Tax Unit unconscionable to the taxpayer?

Section 210 reads in part as follows:

That if the Secretary of the Treasury is unable in any case satisfactorily to determine the invested capital, the amount of the deduction shall be \* \* \*.

Upon a strict and literal interpretation of this language the Secretary of the Treasury is unquestionably authorized to determine that the invested capital can not be satisfactorily determined, and therefore that the assessment should be determined as further provided in the section.

However, it is manifestly the purpose and intent of the excess-profits tax law that the taxpayer shall have a deduction upon all the statutory invested capital which he can establish, and if in any case the taxpayer is able to show to the satisfaction of the Unit that he has statutory invested capital which can be recognized in excess of constructive capital found upon application of section 210 the taxpayer should not be deprived of his right to have assessment based upon such statutory capital as he can show, because there are other items of invested capital which can not be determined and which he taxpayer concedes the right of the Unit to ignore.

11

45-20-1288: A. R. M. 89.

The provision of section 327 of the Revenue Act of 1918, denying the benefits of that section to corporations 50 per cent or more of the gross income of which consists of income derived from Government contracts on a cost-plus basis was, in the opinion of the Committee, designed to cover cases in which the contractor was assured of a profit irrespective of cost, and in which the Government rather than the contractor assumed the risk of loss.

Where the unfinished work of a contractor was commandeered by the Government and it was agreed that he should receive the same compensation as he would have received under the private contract, the fact that he was subsequently compensated on a cost-plus basis after the work was completed



does not, in the opinion of the Committee, operate to change the legal situation in this respect.

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47-20-1318: A. R. R. 326.

If a corporation has paid no salaries to its officers during 1917, or has paid them salaries which were unusually low in comparison with the salaries paid to the officers of competing concerns, and thereby created an abnormal condition which seriously affected its net income and tax liability, it may properly receive consideration with the view to determining its excess profits tax liability for 1917 in accordance with section 210 of the Revenue Act of 1917.

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48-20-1330: A. R. R. 327.

Where a corporation operated its business with a large amount of borrowed capital during the year 1918, and thereby created an abnormal condition which rendered its invested capital disproportionate to its net income as evidenced by comparison with representative corporations engaged in a similar or like trade or business, and where it received insurance on the life of one of its officers which created an abnormal condition with respect to its net income, it may properly receive consideration with the view of determining its excess profits tax liability for 1918, in accordance with sections 327 and 328 of the Revenue Act of 1918.

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50-20-1348: A. R. R. 332.

#### REVENUE ACT OF 1917.

Held, that taxpayer having clearly shown substantial intangible value in a business with small capitalization, the success of which business is not dependent on personal services except as may be normally required for the management of any property of any company, is entitled to relief under section 210 of the Revenue Act of 1917, and may not establish his invested capital for excess profits tax in any other manner.

The Committee has had under consideration the appeal of the M Company and the N Company from the findings of the Income Tax Unit in making assessment of taxes for the year 1917, under section 210 of the Revenue Act of 1917.

In the year 191-, A, B, and C acquired the business of the M Company and the N Company for cash. In each instance the business of the company was acquired and not capital stock. Each company so acquired was immediately incorporated with a capital stock of  $x$  dollars and A, B, and C, the stockholders, turned over to D and E, without other consideration from these two gentlemen than their promise and agreement to conduct the business and do the advertising, one-half in the aggregate of the said stock. In the year 191- D and E sold half of their interest to outside parties and received therefor in cash  $64x$  dollars per share.

Both companies were engaged in the manufacture and sale of a certain commodity and in the year 1917, because of nominal capital outstanding, filed income tax returns as personal service corporations. The audit in the Income Tax Unit brought the two corporations under consolidation and the tax was finally assessed under the provisions of section 210, resulting in a percentage of 3y per cent of excess profits tax to net income as compared with a percentage of 5y per cent, had assessment been made under section 201. The taxpayer submits that the assessment under section 210 imposes too high a tax and that in lieu thereof the tax should be based on certain other methods of determining invested capital, which it does not seem necessary to now refer to in detail.

The business of each company is that of an ordinary commercial enterprise. The value of the capital stock of each is conclusively shown by the original purchases by A, B, and C, and by cash sales between individuals in the year 191—, one year after incorporation. This value is not supported by personal services but by the earning power (potential or otherwise) of certain property not reflected in the capitalization. This certain property is an intangible asset which was actually paid into the company at incorporation but at a nominal value. Had the certain property been a tangible asset, article 63, of Regulations 41, could be invoked for claiming a paid-in surplus.

Article 74, of Regulations 41, defines "nominal capital" and prescribes certain tests, one of which is that corporations having a nominal capitalization but employing a substantial amount of capital in their business will not be construed as businesses having a nominal capital for purposes of excess profits tax. There is no provision in the law or regulations which gives effect to the inclusion of a substantial amount of capital of intangible nature when specifically paid in at nominal value. Manifestly, however, under such conditions the taxpayer is entitled to relief under the equitable provisions of the statute.

Accordingly the Committee recommends that action of the Income Tax Unit in assessing the tax under section 210 of the Act be sustained. In further support of this recommendation attention is directed to Advisory Tax Board Memorandum 9 [which reads as follows: A claim for assessment as a personal service corporation should be denied where the income of the corporation is derived entirely as the result of the ownership of certain property (such as patents) and is in no sense derived from the personal activities of any of the stockholders.].

15

51-20-1359: A. R. R. 338.

The Committee has had under consideration the appeal of the M. Company against the action of the Income Tax Unit in denying assessment under the provisions of sections 327 and 328 for 1918.

Two grounds are urged as a basis for relief under the provisions of sections 327 and 328: (1) That the taxpayer's invested capital can not be satisfactorily determined, and (2) that owing to abnormal conditions affecting the capital and income of the corporation, denial would work upon the corporation an exceptional hardship evidenced by gross disproportion of the tax computed without the benefit of section 327 and the tax computed with reference to the representative corporations specified in section 328.

The grounds for the claim that the invested capital can not be determined



are (a) that the company has a water power site in connection with its factory which is included in the value of land and buildings but the value of which is not susceptible of accurate ascertainment, and (b) that considerable sums of money were expended prior to 1918, in building up its trade-mark and good will.

With respect to the value of the water power site it was brought out at the hearing that the original cost of such water-power site and development is included in the cost of the land and buildings and consequently is reflected in invested capital to the extent permitted under the law.

With respect to the building up of good will, no evidence whatever is presented as to expenditures in this connection. The Committee therefore finds no ground on which to hold that the capital can not be satisfactorily determined.

The abnormal conditions affecting capital and income are apparently that in the prewar period and prior to 1915, the business was not efficiently operated but that since 1915, under new management a reorganization has been effected with results in much greater profit to the company. The Committee is unable to agree that inefficient management, constitutes such an abnormal condition as to be recognizable under the statute.

It is therefore recommended that the action of the Unit in denying assessment in accordance with sections 327 and 328 be affirmed.

16

3-21-1394: A.R.R. 363.

### REVENUE ACT OF 1917.

The Committee has had under consideration the appeal of the M Company, a corporation, from the action of the Income Tax Unit in denying assessment of taxes for the calendar year 1917, upon the basis of section 209 of the Revenue Act of 1917. The company was incorporated in June, 1911, taking over the assets and liabilities of the business of A who, with B, was engaged in developing certain patents. The assets so taken over consisted of  $x$  dollars. Against these assets there were accounts payable aggregating  $\frac{3}{4}x$  dollars, which were assumed. For these net assets capital stock, in the amount of  $2x$  dollars was issued, of which 49 per cent was issued to B, 50 per cent to A, and 1 per cent to D. No additional funds were paid in to the corporation since it appears that A possessed no funds which he could invest, and B, having no faith in the practical ability of the patents, refused further financial assistance. The patents did not prove a success but, as a result of several years of experimental and development work, the corporation secured various patents for automobile bumpers, the use of which it sold to the N Company, which operated the same on a license, paying the M Company royalties on the number of bumpers manufactured. The only income received by the corporation in the year 1917, was from these royalties and it amounted to  $4x$  dollars. The only disbursements made were salaries, attorney's fees, commissions, and certain miscellaneous expenses, the aggregate amount being  $2\frac{1}{2}x$  dollars, leaving net income for the year 1917 of  $1\frac{1}{2}x$  dollars.

It is contended by the taxpayer that the income of the corporation consisted of royalties received from these bumper patents developed by the ingenuity and personal services of the stockholders, and the continuance of these personal services on the part of such stockholders is absolutely essential if the income of the corporation is to continue. The license agreement with the N Company provides that A shall devote his time to demon-

strating, improving, and developing the bumper patents, and it is claimed that the result of these efforts is being reflected in the royalties received by the corporation.

The books of the company are kept on a cash receipts and disbursements basis, and at January 1, 1917, the cash book and stock record book show an asset of cash,  $\frac{1}{2}x$  dollars, liabilities, attorney's fees, and capital stock,  $2\frac{1}{2}x$  dollars.

Article 71 of Regulations 41 provides:

Section 209 \* \* \* applies primarily to occupations, professions, trades, and businesses engaged principally in *rendering* personal service, in which the employment of capital is not necessary, and the earnings of which are to be ascribed primarily to the activities of the owners.

Advisory Tax Board Memorandum 9, published in Bulletin 1-19, covers a case quite analogous to this. The memorandum reads, in part, as follows:

The facts are briefly that the net income of  $9\frac{1}{2}x$  dollars was derived entirely from license fees paid by users of machines embodying the company's patents. This is the only source of revenue that the company now has or ever has had. Certain patents on a new form of mold for vulcanizing tires were assigned to the company. It originally intended to manufacture the tires, but later determined to grant licenses under the patents, and has never engaged in manufacturing. The paid-in capital is  $x$  dollars.

Inasmuch as the income of the corporation is derived entirely as a result of the ownership of certain property, namely, patents; and is in no sense derived from the personal activities of any of the stockholders, other than such activities as are normally required for the management of any property of any company, it is recommended that the claim under section 209 should be denied.

In the instant case capital (patents) is employed in the business. Royalties are the result of the employment of this capital, and it can not be denied that the volume of the business rests practically upon the individual efforts of the stockholders of this corporation. This is true, more or less, in every corporation, and the distinction must be noted between personal service and commercial service.

The company has paid-in capital, but its true invested capital for the taxable year can not be actually determined. At any rate, the income for the taxable year justifies the consideration given the case under section 210 of the Revenue Act by the Income Tax Unit.

The Committee accordingly recommends that the action of the Income Tax Unit in denying assessment of taxes against this corporation under section 209 of the Revenue Act be sustained, and that its action in assessing the tax under section 210 be approved.

17

3-21-1395: A.R.R. 364.

### REVENUE ACT OF 1917.

The Committee has had under consideration the appeal of M Company, a partnership, from a decision of the Income Tax Unit rejecting the excess profits tax return filed for the calendar year ended December 31, 1917, under the provisions of section 209, and making an assessment of excess profits tax under the provisions of section 210.

It appears from the records in the case that the partnership was formed in 190— for the purpose of conducting a wholesale merchandise brokerage business, the firm acting as local brokers of foreign principals in negotiating sales on a commission basis. In addition to its regular business of negotiating sales of merchandise as brokers the firm purchased merchandise from time to time in "pooled cars" which it sold at a profit. The sales negotiated on a



commission basis during the year 1917 aggregated 100x dollars and yielded gross brokerage charges of x dollars, while the amount of merchandise purchased aggregated 22x dollars, which merchandise was sold at a gross profit of  $\frac{1}{2}$ x dollars. A, in an affidavit, states that it is his opinion that the expense of conducting the business could be fairly apportioned so as to charge brokerage sales with 40 per cent and merchandise sales with 60 per cent of the total expense. An allocation of expense on the basis stated by A to each line of business conducted shows that approximately 30 per cent of the firm's net income was derived from sales of merchandise. In reply to inquiries made by the Income Tax Unit the firm stated that it had no branches during the year 1917, employed only one salesman, and that it was not responsible in any event for losses in shipments, bad debts, etc.; that such responsibility rested upon its foreign principals or was a matter of adjustment between foreign sellers and local buyers, and that it did not either directly or indirectly make loans or advances to customers, but did extend short-time credits on merchandise.

The partnership in rendering its returns for the year 1917 computed excess profits tax under the provisions of section 209 based on the contention that its principal net income was due primarily to the personal activities of the two partners. The balance sheets accompanying the returns show, as of January 1 and December 31, 1917, moneys borrowed in considerable amounts and accounts receivable and payable, indicating the use of capital more than nominal in amount of the business.

Because of the volume of business transacted by the partnership during the year 1917 through direct buying and selling of merchandise, and the numerous accounts receivable and payable shown on the firm's balance sheets, both at the beginning and close of the taxable year, the Unit denied assessment under section 209, but, holding that a statutory invested capital of  $\frac{1}{3}$ x dollars was negligible in comparison with the volume of business transacted and seriously disproportionate to the invested capital of other taxpayers doing a like or similar business, assessed tax under the provisions of section 210, basing such assessment upon comparative data compiled in the Unit. The comparatives used appear to be representative and give a tax which is both fair to the Government and to the taxpayer.

In view of the foregoing, the Committee is of the opinion that classification under the provisions of section 209 was properly denied, and that the assessment of the tax as made by the Unit under the provisions of section 210 should be sustained.

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(See 9-21-1486; Section 326, Article 871.) Foreign affiliated corporations.

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15-21-1568: A. R. R. 459.

#### REVENUE ACT OF 1917.

Recommended, where respective values of mixed aggregates of tangible and intangible properties paid in for stocks and bonds can not be satisfactorily determined, that the tax should be assessed under the provisions of section 210 of the Revenue Act of 1917 and articles 18, 24, and 52, Regulations 41.

The Committee has had under consideration the appeal of the M Company, a corporation, from the action of the Income Tax Unit in assessing

taxes for the year 1917 under section 210 instead of under section 207 of the Revenue Act of 1917.

In June, 189—, the M Company acquired the business of a partnership owning and publishing a certain publication. The assets of the partnership consisted of cash, typesetting plant, library, stock of bound volumes, office furniture and fixtures, and copyrights. It is also alleged the partnership had a valuable good will asset. The consideration received by the partnership from the corporation consisted of shares of capital stock (par value 20x dollars) and bonds amounting to 7x dollars.

The corporation, in filing its 1917 tax return, failed to furnish balance sheets at the beginning and end of the taxable year, explaining that the business was entirely on a cash basis. At the request of the Income Tax Unit it subsequently constructed balance sheets as of December 31, 1916, and as of December 31, 1917. The constructed balance sheet as of December 31, 1916, reads as follows:

#### ASSETS.

Paid for copyright and good will at organization of company in 189—, half assigned to each—

Copyright.....	13x dollars
Good will.....	13x dollars
Typesetting plant.....	13x dollars
Library and stock.....	13x dollars
Furniture and fixtures.....	13x dollars
Cash.....	23x dollars

303x dollars

#### LIABILITIES.

Capital stock.....	20x dollars
Bonds issued in 189— and subsequently paid off.....	7x dollars
Increase in cash and other tangible assets since 189—.....	33x dollars

303x dollars

The bonds aggregating 7x dollars, which were issued, were retired within a period of 12 years subsequent to date of issue out of the earnings of the corporation. It is, therefore, contended that retirement of this liability gives the corporation a surplus in amount equivalent to the bond issue of 7x dollars. It is also claimed, as stated in the above balance sheet, that the increase in cash and other tangible assets since 189— gives the corporation additional surplus of 33x dollars. It is further contended that in addition to this surplus aggregating 103x dollars the corporation is entitled to good will of 4x dollars, based on 20 per cent of the capital stock of the corporation outstanding as at March 3, 1917.

A dividend adjustment of 4x dollars has been made by taxpayer, leaving 133x dollars, which the taxpayer claims as statutory invested capital, as against the invested capital of 11x dollars constructed by the Income Tax Unit under the provisions of section 210. This is a case where stocks and bonds were issued by the corporation prior to March 3, 1917, for a mixed aggregate of—

- (a) Tangible property,
- (b) Copyrights, and
- (c) Good will subject to the determination of values as prescribed in article (59) (1) (2) of Regulations 41.

The claim is made that tangible assets at acquisition (189—) could not have been less than x dollars. There is no evidence to support this assertion. The corresponding tangible assets (eliminating cash) at January 1, 1917, are shown at values aggregating 23x dollars and the difference of 13x dollars is unexplained. This increase may or may not represent appreciation.



Assuming the surplus has been increased 7x dollars by the retirement of a liability through income, no evidence has been submitted to show that the value of the copyrights and good will alleged to have been acquired in 189— was in excess of this amount of borrowed capital. On this basis of valuation no cash value could be placed on the capital stock issue of 20x dollars. Only an assertion is made that—

The tangible assets consisting of cash, typesetting plant, library, stock of bound volumes, and office furniture and fixtures had a value of x dollars, thus making the value of the copyrights and good will 26x dollars (20x dollars attributable to stock and 6x dollars attributable to bonds).

and that—

While it is true that the copyrights of the publication have always been and will always continue to be the most valuable asset possessed by the M Company, and in view of the fact that at this late date we can not satisfactorily state its actual worth at the time of its acquisition, we have therefore waived our privilege of having any portion of this 26x dollars treated as copyright and consent to have the entire sum treated as good will.

Article 59 (1) provides that:

In the absence of satisfactory evidence to the contrary, it will be presumed in the case of a corporation, that its stock was issued for the following purposes in the order named:

- (a) Good will or other intangible property,
- (b) Patents and copyrights, and
- (c) Tangible property.

This article (2) further provides that:

Upon the production by the taxpayer of evidence satisfactory to the Commissioner of Internal Revenue as to the actual values at the date of acquisition of (a) the tangible property, and (b) the patents and copyrights, the sum of these two items may be applied against the total par value of the securities issued and the remainder will then be deemed to represent the par value of the securities issued for the good will or other intangible property. (3) Cases where mixed aggregates of tangible and intangible property have been paid in for stock and bonds shall, if the Secretary of the Treasury is unable to determine satisfactorily the respective values of the several classes of property at the time of payment, be treated as coming under articles 18 and 24 and the tax shall be assessed accordingly.

Articles 18 and 24 are regulations applicable to section 210 of the Revenue Act and from what has been stated it is clearly apparent that the respective values of the tangible and intangible properties acquired by the corporation in 189— can not be satisfactorily determined. The Committee accordingly recommends that the action of the Income Tax Unit, in disposing of this case under section 210 of the Revenue Act of 1917, be sustained.

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#### REVENUE ACT OF 1917.

17-21-1588: A. R. R. 464

Recommended, in the appeal of the M Company that the action of the Income Tax Unit in denying assessment under section 209 of the Revenue Act of 1917 be sustained, and that the said corporation's excess profits tax liability be determined under the provisions of section 210 of that statute.

The committee has had under consideration the appeal of the M Company, from the action of the Income Tax Unit in denying assessment under section 209 of the Revenue Act of 1917 and assessing excess profits tax under the provisions of section 201 for the fiscal year ended March 31, 1917.

It appears from the records in the case that during the taxable year in question the four officers of the company owned all of the stock and gave their entire time and attention to the business, that of obtaining exclusive selling contracts covering lots, tracts, and other parcels of land and the disposal of such lands on a commission basis. It does not appear that the company made any purchases and sales of lands on its own account nor that

it assisted in the financing of real estate operations, except that in a very few cases where the purchasers of lands were unable to continue their payments under the terms of their contracts and the company would lose its commission should such contracts lapse, and in one or two instances where such losses and lapse of contracts would result in a serious hardship to the purchaser of the lands the company assumed such contracts and resold them.

It further appears that the company was organized with an authorized capital of \$3,000, of which amount \$2,000 was subscribed for and paid in prior to January 1, 1917, and that no addition to capital has been made since the organization from any source other than from earned income, funds, however, being borrowed occasionally to meet payrolls and expenses at times when the collection of commissions earned has been deferred. The taxpayer contends that it requires and employs no more than a nominal capital in the conduct of its business, that the character of its business is such that capital is not required, and that its success is due to and its net income is derived solely from the activities of its officers, all of whom are stockholders. To this contention the Committee does not agree for the reason that it is shown that in the conduct of its business the corporation does require capital and that its income is derived in a large part from services rendered by others.

Under its usual form of contract the company, in taking over a subdivision for sale, obligates itself to bear all selling expenses such as newspaper advertisements, printed matter, signs, and the cost of erecting branch offices on the property offered for sale. During the year in question advertising, auto expenses, miscellaneous expenses, and supplies, as shown by taxpayer's original return, amounted to 4x dollars. It also obligates itself to render various forms of service, such as planning and supervising the placing of properties on the market, the making of sales and collections, and the accounting for and remitting of collections made, to furnish surety bonds for the faithful performance of its contracts, to supervise the entire work of preparing the property for market, including the negotiation and letting of contracts, subject to the approval of the owners of the land, with all engineers and contractors, and the laying out and construction of improvements by such engineers and contractors, to negotiate with all public and private corporations and public authorities for permission to construct and connect improvements in conformity with private rights and public law, and to prepare and publish such advertising matter as is deemed necessary. These duties are discharged in part by the four officers of the corporation and in a large part by its superintendents and salesmen working on a commission basis and its salaried office force. The compensation of the corporation for the rendition of such services is received in the form of commissions based on the amount of sales made by its salesmen, an average of twenty-five being employed, each of whom receives a stated percentage of the commissions received on the sales made by him. The superintendents who direct and supervise the activities of the salesmen and perform other duties receive a commission of 2 per cent on all sales made. The balance of the commissions received accrues to the corporation.

In view of these facts it is the opinion of the Committee that the business of the corporation is such as that ordinarily requiring the use of capital, and inasmuch as a substantial part of the income received is derived from services rendered by the company's superintendents and salesmen, the Committee holds that the Unit was correct in denying assessment under section 209 and recommends that such action be sustained.

The corporation in preparing its return for the fiscal year 1917, reported on the accrual basis, showed a net income of 35x dollars, and computed the



excess profits tax thereon under the provisions of section 209. It is shown that the corporation is entitled, under its usual form of contract, to a commission of from 10 per cent to 30 per cent on the gross sales price of each property sold, that it usually deducts 5 per cent of such sales price from the initial or "down" payment, in part payment of its commission, and a portion of each subsequent installment payment until its entire commission is satisfied. Under this plan of realizing its commissions the company must wait from two and one-half to five years, and in some instances a much longer period, before it finally receives payment in full for its services. It is stated that the company attempted to make a return on the actual receipt and disbursement basis but was forced by the Collector of its district to report on the accrual basis.

It is the opinion of the Committee that the alleged action of the collector in refusing to permit the corporation to report on an actual receipt and disbursement basis was not justified. It is shown that the responsibilities and duties of the company under its usual form of contract with the owners of the properties to be sold, in consideration for the assumption of which responsibilities and the discharge of such duties, commissions are to be received, are not fully discharged and the commissions fully earned until the last installment payment is received from the purchaser, and therefore to report the full amount of commissions called for under sales contracts as income for the year during which such contracts are entered into is to report as income for that year commissions which have not been fully earned and which, in case of default, will never be received.

The revenue agent reported a net income of 14x dollars, computed on the actual receipt and disbursement basis, and an invested capital of 10x dollars for the fiscal year 1917, and stated that the company and its accountant agreed with this report except in respect to his decision that the company was not entitled to classification as a personal service corporation.

After a careful consideration of all the facts presented the Committee is of the opinion that the M Company is not entitled, for the fiscal year 1917, to assessment under the provisions of section 209 as a personal service corporation or one employing only a nominal capital. In connection with this case, however, the Unit has prepared a comparative data sheet, using a number of comparatives.

From these comparatives it is apparent that the amount of statutory invested capital allowable to the M Company for the taxable year 1917, is small when compared with that of other taxpayers engaged in a like or similar business, which fact would, through the operation of section 207, place that corporation at a serious disadvantage in comparison with such other taxpayers, and that the percentage of excess profits tax to net income assessed against it for the said taxable year is grossly disproportionate to such percentage in the case of other corporations engaged in a like or similar business. In comparison with the amount of business done the appellant does not appear to have a normal amount of capital invested in its business, owing to which fact it found itself obliged from time to time to borrow funds with which to meet its pay rolls and current expenses. It does not appear to have enjoyed any particular advantage over other corporations doing a similar business.

Article 52 of Regulations 41 provides, in part, as follows:

Section 210 provides for exceptional cases in which the invested capital can not be satisfactorily determined. In such cases the taxpayer may submit to the Commissioner of Internal Revenue evidence in support of a claim for assessment under the provisions of section 210. (See articles 18 and 24.) Such exceptional cases may consist, among others, of the following:

(3) Long-established business concerns which by reason of ultraconservative accounting or the form and manner of their organization would, through the operation of section 207, be placed at a serious disadvantage in competing with representative concerns in a like or similar trade or business.

Section 327(d) of the Revenue Act of 1918 provides, in part, that—

Where upon application by the corporation the Commissioner finds and so declares of record that the tax if determined without benefit of this section would, owing to abnormal conditions affecting the capital or income of the corporation, work upon the corporation an exceptional hardship evidenced by gross disproportion between the tax computed without benefit of this section and the tax computed by reference to the representative corporations specified in section 328.

While the above-quoted provision of the Revenue Act of 1918 will not be applied in any case in which the tax computed without its benefit is high merely because the corporation earned in the taxable year a high rate of profits upon a normal invested capital, in the opinion of the Committee it confirms the interpretation which has been placed upon section 210 of the Revenue Act of 1917 and articles 18, 24, and 52 of Regulations 41.

It having been shown that the M Company employed more than a nominal amount of capital in its business during the taxable year ended March 31, 1917, and derived a considerable part of its net income from services rendered by others than its four stockholders, the Committee recommends that the action of the Unit in denying assessment under the provisions of section 209 be sustained. And further, in view of the fact that the said corporation was ultraconservative in its capitalization and the further fact that the amount of capital it had invested in the business was insufficient at times to meet the needs of that business and was less than normal as compared with the amount of business transacted and as compared with the amount of capital employed by other concerns doing a similar business, the Committee recommends that the case be returned to the Unit for adjustment and assessment of excess profits tax under the provisions of section 210 on the basis of the average percentages shown on the data sheet submitted to the Committee.

21

21-21-1645: A. R. R. 500.

#### REVENUE ACT OF 1917.

**Recommended, in the appeal of the M Company that the action of the Income Tax Unit be reversed and that assessment of the excess profits tax of this corporation be made in accordance with the provisions of section 209 of the Revenue Act.**

The Committee has had under consideration the appeal of the M Company from the action of the Income Tax Unit in denying assessment of taxes for the year 1917 under section 209 of the Revenue Act of 1917.

The M Company was organized in March, 1917, for the purpose of doing a brokerage business in metals. The company has paid-in capital stock of  $\frac{1}{3}x$  dollars issued in three shares. Its gross sales for the year 1917 amounted to 183x dollars and its cost of goods sold amounted to 165x dollars. The only expense of the corporation consisted of a salary of  $1\frac{1}{2}x$  dollars paid to its president, who owns one share of stock, and  $\frac{1}{6}x$  dollars paid for incorporation and legal services. Its net income was, accordingly, 16x dollars and its balance sheet at the close of December 31, 1917, shows capital stock,  $\frac{1}{3}x$  dollars, surplus, 16x dollars, this latter amount representing the net income of the year as stated. The treasurer and the secretary of the corporation are its other stockholders.

The Income Tax Unit denied the right of assessment under section 209, and because of the relation of the corporation's income to its invested capital the tax was assessed under the provisions of section 210 of the Revenue Act.



This assessment resulted in an excess profits tax of  $y$  per cent of net income, resulting in an additional tax of  $4x$  dollars.

The taxpayer under his contention for assessment under section 209 claims that 99 per cent of the business of the company consisted of brokerage collected on sales made to the N Company, that the arrangement with this company was that it should be furnished with a certain product in quantities such as they might order, and that the broker should be paid a certain brokerage over and above the mill price, the mill price being known to the purchasers. The taxpayer made the collections from the N Company and paid to the mills the price of the product purchased. It is stated that it was so arranged that capital was not necessary in these transactions, since the N Company was required to pay for the product furnished it prior to the date on which the M Company was required to pay the mills. The corporation accordingly rests its case on its claim that it transacts brokerage business only, that it has a mere nominal capital of  $\frac{1}{3}x$  dollars, and that during the year of 1917 it was the personal equation of its president that made it possible for this corporation to conduct any business whatever.

The Income Tax Unit contends that the corporation was trading as a principal, making contracts direct with the purchaser and assuming responsibility thereunder, and that accordingly its tax can not be adjusted under section 209 of the Revenue Act.

Article 73 of Regulations 41, revised, provides that:

Agents and brokers requiring and using no capital or merely a nominal capital in their business are taxable under article 15, but commission houses regularly employing a substantial amount of capital, whether to lend to principals or to carry goods on their own account, are not deemed to be agents or brokers and are taxable under the provisions of article 16.

In the instant case it is clearly apparent that only nominal capital was employed in the business. No advances were made to the manufacturer, and collections from the purchaser only passed through the hands of the brokers. The goods were shipped direct to the purchaser, and therefore the officers of the corporation required no offices and no clerical assistance. It was merely a matter of securing orders for the product and placing these orders with the manufacturer. It was admitted in conference that under the contracts with the purchaser the M Company might be sued, but in view of the recognition by the purchaser that the M Company was merely acting in a brokerage capacity, without capital to insure recovery under any breach of contract, the real responsibility rested in the manufacturer, and that in event there should be any right of action it would rest against the purchaser. In view of this, the representatives of the taxpayer contend that for the purpose of arriving at a proper tax the Department should look beyond corporate form if it is considered the corporation was trading as a principal.

The Committee recognizes that it is only on the theory that the M Company might be held responsible under its contracts that assessment under section 209 can be denied. It considers, however, that the nominal capital of the corporation clearly establishes the fact that it was not contemplated it should be held responsible except by way of personal service to both the buyer and seller, and accordingly the corporation clearly comes within the contemplation of the section of the Act itself which provides that a corporation doing business on a nominal capital, or without any capital, should be assessed for excess profits tax at the rate of 8 per cent on its net income.

The Committee accordingly recommends, in the instant case, that the action of the Income Tax Unit be reversed and that assessment of the excess profits tax of this corporation be made in accordance with the provisions of section 209 of the Revenue Act.

22-21-1668: A. R. R. 518.

## REVENUE ACTS OF 1917 AND 1918.

Recommended, that the action of the Income Tax Unit in denying the M Company special consideration under section 210 of the Revenue Act of 1917, and under sections 327 and 328 of the Revenue Act of 1918, be sustained.

The Committee has had under consideration the appeal of the M Company from the action of the Income Tax Unit in denying assessment under section 210 of the Revenue Act of 1917, and sections 327 and 328 of the Revenue Act of 1918.

The M Company was organized and incorporated in 1906 with capital stock issued and outstanding amounting to 8x dollars. Of this amount x dollars was issued to A and charged to good will on the books of the corporation. This contribution was in recognition of the experience of A and his success as a salesman in the territory in which the corporation was located.

The corporation filed its returns for the fiscal year ended May 31 1918, computing income and profits taxes under the provisions of section 201, and under the provisions of section 328 at the rate of 50 per cent of its net income. The corporation subsequently filed a claim for consideration under the provisions of section 210 of the Revenue Act of 1917, and sections 327 and 328 of the Revenue Act of 1918, based on the following reasons:

1. That the case of the taxpayer is an exceptional one, and its invested capital can not be used as the basis for assessing the excess profits tax without resulting in an unduly burdensome tax, because the invested capital is seriously disproportionate to the taxable income.

2. That the income of the taxable year represents the fruit of activities antedating the taxable year.

3. That the operation of section 207 would place it at a disadvantage in competing with representative concerns.

The books of the corporation have been examined by a revenue agent and its invested capital has been clearly established. This is recognized by the taxpayer who relies, under the above contentions, principally on the value of the services of A who is president of the corporation and who, in 1917, acquired practically all of the stock of the corporation, and upon the fact that in 1916 a very satisfactory contract was made from which it is claimed about one-fourth of the income of the company is derived. This contract, in effect, provided for the purchase of a finished product to be made from steel at a price which would yield a reasonable profit over all costs, whatever they might prove to be. It is stated, however, that the purchase amounted to more than a normal year's supply and that delivery has not yet been completed. The taxpayer was accordingly able to supply its customers at the high prevailing prices in the year 1918 and to realize the correspondingly large profits. Its net income for the fiscal year ended May 31, 1917, was 8x dollars and its net income for the fiscal year ended May 31, 1918, was 22x dollars. The invested capital at the beginning of the fiscal year ended May 31, 1917, was 30x dollars and at the beginning of the fiscal year ended May 31, 1918, was 38x dollars, while at the close of the fiscal year ended May 31, 1918, it was 61x dollars, which reflected the undistributed income of 22x dollars for that year. The income and profits taxes assessed by the Unit for the fiscal year ended May 31, 1918, amounted to 12x dollars, which amount, deducted from the income for the year, leaves a balance of 10x dollars for dividends, or approximately 27 per cent of the invested capital at the beginning of the taxable year.

It is contended that A's personality is a most important factor in the business and that possibly consideration should be given for assessment of



the company's taxes under section 209 of the Revenue Act of 1917, but this section of the law manifestly is not applicable because of the amount of capital employed in the business nor can A's services be considered as creating an abnormal condition because he had been constantly employed in the development of the business since its incorporation and the value of his services was recognized in the first instance by the corporation's contribution of  $x$  dollars of its stock which it charged to good will.

Section 210 of the Revenue Act of 1917 provides for an equitable adjustment of the tax when the invested capital of a corporation can not be satisfactorily determined, and in giving recognition to the intent of this section, article 52 of Regulations 41 provides that when invested capital is seriously disproportionate to taxable income because of the realization in one year of the earnings of capital unproductively invested through a period of years or of the fruits of activities antedating the taxable year, adjustment of the tax may be made under the provisions of section 210.

The Committee, after careful consideration of all the facts in the instant case, finds that the business of the M Company gradually and satisfactorily developed from the date of its incorporation with consistent earnings in the years 1916, 1917, and 1918 available for dividends. The capital stock of the company was only  $8x$  dollars and yet at the beginning of the year 1916 the company has a surplus of  $22x$  dollars.

In the final analysis of the case it would seem that taxpayer's contention substantially rests only on an abnormal condition brought about by a business contract which resulted in material advantage to the taxpayer by virtue of circumstances which, in the year 1918, were reflected in very high prices for the product of this corporation. It is not thought this is such an abnormal condition as might be contemplated under article 52 of Regulations 41 or under section 327 of the Revenue Act of 1918. The contract was a simple business proposition which, like many other contracts, resulted in large profits during the year 1918 and it might be said in corresponding losses in subsequent years. The right to claim such losses is recognized in certain sections of the Revenue Act of 1918 and in the regulations promulgated thereunder. Surely, under such conditions, there is no good reason why a corporation receiving large profits in the year 1918 in the ordinary conduct of its business should not pay taxes under the prescribed provisions of the law without special consideration under the equitable provisions of the law. The ratio of excess profits tax, in the instant case, is something in excess of 50 per cent, but there are other corporations having similar favorable contracts made in the ordinary course of business which paid tax at equally as high a rate.

The Committee accordingly recommends that the action of the Income Tax Unit in denying the M Company special consideration under section 210 of the Revenue Act of 1917 and under sections 327 and 328 of the Revenue Act of 1918, be sustained.

23

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(See 27-21-1720; Section 326, Article 853.) Assets in custody of trustees in liquidation.

24

28-21-1730: A. R. R. 538

Recommended, that the M Company, formerly the N Company, be granted the benefit of assessment of excess profits and war profits taxes for the year 1918 under the provisions of sections 327 and 328 of the Revenue Act of 1918; that in the preparation of a comparative data sheet particular care be used to select only such comparatives as are fair both to the Government and to the taxpayer; and that the Unit be sustained in restoring to the closing inventory for that year the fruit on hand in warehouses and in transit to market but not marketed and sold as of December 31, 1918.

The Committee has had under consideration the appeal of the M Company, formerly the N Company, from the action of the Income Tax Unit in computing the amount of war profits credit to be allowed the corporation for the year 1918 under the provisions of section 311(a) of the Revenue Act of 1918 and including in the closing inventory for that year the amount of fruit on hand in warehouses ready for sale.

It appears from the records in the case that in 190— the N Company was organized for the purpose of taking over certain real estate and securities owned by a partnership and the business of growing, shipping, and selling fruits conducted by it, and incorporated with an authorized capital stock issue of 10x dollars which was in 1917 reduced to 7½x dollars. The name of the corporation was changed in 1920 to the M Company and the revenue agent who investigated the corporation's income tax returns for the years 1909-1919 reported:

The corporation was formed to take over certain real estate and securities which were owned by A and B and operated by them as a partnership. In setting up these accounts on the books at the time of incorporation the officers placed very conservative figures upon the buildings and equipment and upon the real estate. \* \* \* An examination of the books of the partnership for 1905 and the first half of 1906 would indicate that the value of the good will based upon the earnings for this period would be at least three times the total value claimed.

which statement indicates that the corporation was very conservatively capitalized.

During the prewar period 1911-1913 the corporation's orchard was divided into two units, one containing about r acres in full bearing, the other about r acres of young trees which had not yet reached the productive state and in which a considerable portion of the corporation's invested capital was tied up, due to which fact the corporation claims its net income for the prewar period was abnormally low as compared with its invested capital for the same period.

In an affidavit executed by A under date of October 13, 1920, it is stated that the average yearly yield of the old orchard for the prewar period was 38y boxes of fruit, that the profit per year for that period was z dollars plus per box. For the year 1918 the yield of both old and new orchards was 72y boxes and the average net profit per box z dollars plus.

The corporation contends that inasmuch as the figures submitted show conclusively that it did not benefit by war profits it should not be called upon to pay a war profits tax, and submits the following:

In order to arrive at a fair basis for assessing the war profits tax we suggest that the war profits credit be computed as follows:

To the average net income for the prewar period add a figure representing the increased production in 1918 in boxes over the prewar period times the average profit per box in the prewar period. In other words, if during the prewar period our orchards had been in the same bearing condition they were in 1918 it is reasonable to assume that they would have produced as much fruit as they did in 1918, or 72y boxes a year instead of an average of 38y boxes. Therefore an amount representing the increase in 1918, namely 34y boxes, times the average prewar profit per box should be added to our average prewar profit in determining the war profits credit.



This contention and suggestion may be dismissed upon the mere statement that the net income of a corporation need not be derived solely from so-called "war profits," that is, the increase in normal profits by reason of a greater demand and higher prices due to war conditions, to be subject to the tax complained of, and that there is no provision in the Revenue Act of 1918 which would permit the allowance of a war profits credit computed on the basis suggested by the appellant corporation. The Committee is, however, of the opinion that due to conservative capitalization, the realization of net income in 1918 resulting from the investment of capital which was nonincome producing during the prewar period and for a number of years subsequent thereto, and the payment of salaries to officers which were extremely low as compared to salaries paid by other concerns engaged in the same line of business of similar volume (one salary only being paid to an officer of the company for 1918), abnormal conditions existed during 1918 and that the assessment of excess profits and war profits taxes for that year under section 301 of the Revenue Act of 1918 will work upon the corporation an exceptional hardship evidenced by gross disproportion between the tax so computed and the tax assessed against representative corporations. The Committee therefore recommends that, bearing these abnormal conditions in mind, the Unit carefully prepare a comparative data sheet and grant the corporation assessment under the provisions of sections 327 and 328 of the Revenue Act of 1918.

With reference to the question of inventory the taxpayer states:

From the time that this corporation was first organized an inventory of the fruit in storage in the packing house had been made weekly, principally for insurance purposes, and erroneously at the end of every year the estimated value of the fruit in the packing house and shipped, but not marketed and sold, was carried on to the books, and this policy of carrying the fruit inventory on to the books was continued until the year 1918, at which time the inventory was omitted owing to the fact that it is our understanding that farmers and farming corporations are required to make their returns on the basis of produce actually marketed and sold during the year, and it was the intention of the corporation, as explained to the revenue agent who investigated the returns, prior to the commencement of his examination, to file amended returns for previous years eliminating the fruit inventory and adjusting the income so that it would show only the profits on fruit actually marketed and sold.

The taxpayer further states various reasons which in its opinion precludes an exact determination of a fruit-growing corporation's true net income if the fruit gathered and in warehouse, together with fruit en route to market but not sold, is included in the inventory.

The revenue agent who investigated the corporation's books reported that—

For 1918 the company purposely left out of the books  $\frac{1}{2}x$  dollars of fruit in packing house on the theory that it had the right to make a return on the basis of farmer who keeps no books and report only the income derived from products *actually marketed and sold*.

The agent restored to the closing inventory for 1918 this item of  $\frac{1}{2}x$  dollars, which action was approved by the Unit and appealed from by the taxpayer.

As shown by the records in the case the corporation, from the time it was organized down to the close of 1918, kept books of account and regularly took inventories which were carried to those books and in which was included the fruit on hand in warehouses and in transit to market, but not marketed and sold. Its net income for each year was determined and its tax returns rendered on this basis, and there is nothing to show and the taxpayer does not claim that it ever applied for permission to change from the method regularly employed to an actual receipt and disbursement basis. The Committee is

therefore of the opinion that the Unit should be sustained in its refusal to accept the 1918 tax return of the M Company as originally rendered.

It was optional with the taxpayer whether it should return for tax purposes on an inventory basis or on the basis of actual receipts and disbursements. It adopted the first-mentioned method and followed the same for a number of years. An approved method of reporting income for tax purposes once adopted should be consistently followed from year to year, and permission to change from one approved method to another should not be lightly granted and only granted after a formal request for permission to change has been received from the taxpayer and approved by the Commissioner. While in the instant case the taxpayer now claims that returns rendered on a basis which requires the inclusion in inventories of fruit on hand in warehouses and in transit at the close of a taxable year, but not marketed and sold, does not truly reflect its net income for that year it followed such a method of accounting and rendering of returns for nearly ten years without protest. At the close of 1918 it realized that market conditions were such that a return rendered on the basis of actual receipts and disbursements would, if accepted, show as taxable net income an amount much less than would be shown by a return rendered on the basis formerly followed, and this appears to be the controlling reason for a desire to change; and, in the opinion of the Committee, it is such a one as can not, under the circumstances, be properly recognized.

In view of the foregoing the Committee recommends that the M Company, formerly the N Company, be granted the benefit of assessment of excess profits and war profits taxes for the year 1918 under the provisions of sections 327 and 328 of the Revenue Act of 1918; that in the preparation of a comparative data sheet particular care be used to select only such comparatives as are fair both to the Government and to the taxpayer; and that the Unit be sustained in restoring to the closing inventory for that year the fruit on hand in warehouses and in transit to market, but not marketed and sold as of December 31, 1918.

25

37-21-1823: A. R. R. 599

Recommended, in the appeal of the M Company, that the action of the Income Tax Unit in denying to the said company assessment of profits tax for the year 1917 under the provisions of section 210 of the Revenue Act of 1917 and for the year 1918 under the provisions of sections 327 and 328 of the Revenue Act of 1918 be sustained.

The Committee has had under consideration the appeal of the M Company from the action of the Income Tax Unit in denying to the taxpayer assessment of profits taxes for the year 1917 under the provisions of section 210 of the Revenue Act of 1917 and for the year 1918 under the provisions of sections 327 and 328 of the Revenue Act of that year.

The grounds upon which the taxpayer contends that profits taxes for the years 1917 and 1918 should be assessed under the provisions of the said sections as stated in its appeal of February 26, 1921, addressed to this Committee, are as follows:

In view of the fact that our corporation is denied the inclusion in invested capital of a part of the good will asset which was acquired for capital stock, and in view of the further fact that this good will value is in reality much greater than the amount of capital stock issued therefor, it appears that the Income Tax Unit is in error in stating that there is nothing abnormal in regard to the invested capital of this corporation.

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It also appears that asset account representing machinery actually in use in the business was charged off in 1907 and subsequent years thereby making the capital amount appear smaller in the books than is really the case if the true investment of the corporation could actually be shown.

In regard to the income of the corporation, the figures now at your disposal as contained on the income tax returns for the years 1917 and 1918 indicate very plainly that the profits of these years are abnormal as compared with earnings of our corporation for previous years. This fact in itself indicates that the large profits made in the years for which relief is claimed through your Committee are based to a great extent upon the building efforts of the previous years when incomes were very much smaller.

The records in the case indicate that prior to 1907 the taxpayer was operating under a charter granted under the laws of the State of Y and that in 1907 it was reorganized under the laws of Z in order that it might hold legal title to real property in that State. Upon reorganization its authorized capital stock was increased from 10x dollars to 50x dollars and the stock of the reorganized company was issued to the holders of the old stock in proportion to their original holdings.

The revenue agent who investigated the returns of the taxpayer reported that its opening balance sheet at time of reorganization was as follows:

Cash .....	10x dollars.		
Merchandise .....	9x dollars.		
Bills receivable .....	1x dollars.		
Machinery .....	16x dollars.		
Accounts receivable .....	6x dollars.	Accounts payable .....	5x dollars.
Good will .....	13x dollars.	Capital stock .....	50x dollars.
	<u>55x dollars.</u>		<u>55x dollars.</u>

The revenue agent reported that the officers of the appellant company state that the reorganization was made solely for the purpose of securing a charter in Z in order the the taxpayer could hold legal title to real property in that State. No new stockholders were admitted. The ownership of the stock in the reorganized company being the same as the ownership of stock in the original, the item of 13x dollars set up on the books as good will serves as a balancing entry, or offset, to the increase in capital stock over net assets. It does not appear that the company as reorganized possessed one dollar's worth more of any tangible or intangible asset than it possessed immediately prior to that reorganization. It took over the assets and assumed the liabilities of the old organization together with any and all good will attached to the business. It has not been shown, nor claimed, that any amount was ever actually expended by either the old or the new organization in the acquirement of good will and yet, because of the fact that a reorganization was effected and an item of good will was entered upon the books in an amount equal to the excess of par value of new stock over the net value of the assets taken over, the taxpayer is now in a position to claim and be allowed under the provisions of section 207(a) of the Revenue Act of 1917 as statutory invested capital 10x dollars for the year 1917 on account of good will and 12½x dollars for the year 1918 under the provisions of section 326(4) of the Revenue Act of 1918. The mere fact that the taxpayer can not be allowed to include in its statutory invested capital the full amount of good will it wrote on its books at time of reorganization, even though that amount is less than the actual value of the good will at that time, as is claimed in this case, does not, as it contends, create such an abnormal condition with regard to statutory invested capital as would entitle it to assessment of profits taxes under the provisions of the said sections 210, 327, and 328.

In support of its claim that "asset account representing machinery actually in use in the business was charged off in 1907 and subsequent years" the tax payer has submitted no specific and detailed statement, although it apparently has been afforded full opportunity to do so.

From the records in the case it appears that the books of account have been carefully kept and that no great difficulty would be experienced in determining just what amounts, if any, charged off to any asset account may now be properly restored under the provisions of the law and regulations as an increase in invested capital. If this be true, the mere fact that an asset account has been, in the past, improperly reduced through excessive depreciation charges or otherwise, does not in itself preclude adjustment now nor a satisfactory determination of the company's statutory invested capital, and it does not in itself entitle the company to assessment under section 210, nor sections 327 and 328. The records in the case do not disclose any abnormal condition here.

The third reason advanced by the taxpayer in support of its contention that it is entitled to assessment of profits taxes under the provisions of the said sections 210, 327, and 328, is that its profits for the years 1917 and 1918 "are abnormal as compared with earnings of our corporation for the previous years" and that "this fact in itself indicates that the large profits made in the years for which relief is claimed \* \* \* are based to a great extent upon the building efforts of the previous years when incomes were very much smaller."

After a careful consideration of all the facts disclosed by the records in the case the Committee is of the opinion that there was not in 1917 nor 1918 a realization of the earnings of capital unproductively invested or employed through a period of years, nor of the fruits of activities antedating the years 1917 and 1918. The realization of large profits during the years 1917 and 1918 was undoubtedly due in a large measure to war conditions. The taxpayer is engaged in the manufacture and sale of certain articles, and, as has been repeatedly demonstrated to this Committee in similar cases relating to concerns engaged in a like or similar business, the demand for and production of such articles of manufacture were greatly increased by the entrance of the United States into the World War, with a corresponding increase in the profits derived from their larger manufacture and sale.

The taxpayer's return for 1916, the year just preceding that during which the United States entered the war, shows gross sales amounting to 104½ dollars, its 1917 return shows this item increased to 142½ dollars, and its 1918 return to 191½ dollars. The taxpayer was engaged in the same trade or business during the years 1917 and 1918, as it was for many years previous. It has not been shown that any great amount of its capital, if any, remained unproductively employed through a period of years, nor that any asset in which any of its capital was invested remained inactive through such a period. Under the circumstances the realization of greater profits in 1917 and 1918 than in prior years does not indicate to this Committee the existence of any abnormal condition. As a matter of fact the failure of the taxpayer to realize greater profits in 1917 and 1918, in view of the greater volume of business transacted would more clearly indicate the existence of such a condition.

In view of the foregoing, the Committee recommends that the action of the Income Tax Unit in denying to the M Company assessment of profits tax for the year 1917 under the provisions of section 210 of the Revenue Act of 1917 and for the year 1918 under the provisions of sections 327 and 328 of the Revenue Act of 1918 be sustained.



37-21-1817: A. R. R. 556.

# THE REVENUE ACT OF 1917.

Recommended, in the appeal of the M Company, that the action of the Income Tax Unit in disallowing a deduction of 15x dollars claimed for the year 1917 on account of depreciation in the value of liquor license be sustained, and that the corporation be granted assessment of excess profits tax for the year 1917 under the provisions of section 210 of the Revenue Act of 1917.

The Committee has had under consideration the appeal of the M Company for the allowance of a deduction of 15x dollars for the year 1917 to cover depreciation in the value of a liquor license and for the assessment of excess profits tax for that year under section 210 of the Revenue Act of 1917.

The records in the case show that A, from 1905 until his death in 1913, conducted a wholesale and retail liquor business. After his death, B, his sole legatee, continued the business until November, 1913, and then incorporated the same under the name of the M Company with an authorized capital stock issue of 50x dollars, which stock she accepted in exchange for all the fixtures, leases, stock in trade, etc., of the business, said to have been appraised at about the time of the incorporation as having a value of 200x dollars. In an affidavit dated January, 1921, one E states that he was associated with A from 1905 until 1910 as manager of the latter's store, that he had access to A's books of account from 1905 to 1913 and knew fully the extent of the said business and the profits derived therefrom during such time. E further states that in 1910, when he left A's employ, the latter had approximately 150x dollars invested in the business, that subsequent to 1910 and until the death of A in 1913, the latter's capital investment had increased approximately 25 per cent and that the yearly profits from the business from 1905 to 1913 were equal to 50 per cent or better on the invested capital; and he expressed the belief that at the time B incorporated the business its assets were worth in excess of 150x dollars.

In February, 1915, B disposed of all her stock in the M Company to one C, at a price which is not stated, and he managed and controlled the business until June, 1915, when he disposed of all its capital stock to D and E for 175x dollars. In determining the amount to be paid for the capital stock D and E appraised the assets of the business back of the capital stock to be worth the following amounts:

Bills and accounts receivable.....	42¼x dollars.
Fixtures and furnishings.....	34½x dollars.
Merchandise.....	83¼x dollars.
Liquor license.....	15x dollars.
	<hr/>
	175x dollars.

In the merchandise account was included the actual cash surrender value of the liquor license under which the business was operated, or 3½x dollars, which license had been taken out September, 1914, at a cost of 10x dollars to run for one year. The additional value of 15x dollars placed upon this license was its estimated selling value over its cash surrender value at the time the capital stock of the corporation was purchased from C. At that time local laws restricted the number of licenses that could be outstanding and operative in the city. Each license was for the operation of a liquor business at a certain specified street address and was renewable from year to year. It could not be transferred to another address but was transferable from one holder to another. This created a ready market for each such license outstanding and license sales were being made at from 15x

dollars to 30x dollars over and above the cash surrender value of the license. Immediately after their purchase of the capital stock of the M Company D and E installed a new set of corporate books and in opening same they had set up a license account showing a value of 15x dollars. In 1917, due to the enactment of prohibition laws, it was considered that this license right had become worthless and the item of 15x dollars was charged off as a loss and claimed as a deduction against gross income for that year, which deduction was disallowed by the Income Tax Unit.

In the opinion of the Committee the action of the Income Tax Unit in disallowing the said deduction of 15x dollars should be sustained for the following reasons: The transaction in which B sold her holding of capital stock in the M Company to C was a transaction solely between two individuals and not one between an individual and a corporation. It resulted in the sale of the said capital stock and not in a sale of the corporation's assets. It was a transaction to which the corporation itself was not a party. The same is true of the transaction in which C sold the same stock to D and E. The latter paid 175x dollars for the capital stock of the M Company. They did not purchase that corporation's assets as such and neither transaction effected any change in the corporation's invested capital. The only amount the corporation ever had invested in the license was the amount paid therefor, or 10x dollars, and inasmuch as that license was taken out September, 1914, and ran for only one year, the corporation was entitled to claim the proportionate part of that amount properly chargeable to the period September to December 31, 1914, as an expense deduction for the year 1914 and the balance as a deduction for the succeeding year. In a similar manner the amount paid for a renewal of the license in 1915, 1916, and 1917 could have been and probably was claimed as a deduction. Even though the license had been regarded as a capital asset and not as an expense deduction, appreciation in its value over cost was not properly returnable as income for tax purposes nor allowable as a deduction when wiped out by subsequent events.

The Revenue Act of 1917 provides that if the Secretary of the Treasury is unable in any case to satisfactorily determine the invested capital the provisions of section 210 of that Act shall apply. The taxpayer in the instant case claims assessment under that section, and, in the opinion of the Committee, that claim should be granted. It appears clear from the records in the case that at the time the business of A was incorporated the assets transferred in exchange for capital stock of the par value of 50x dollars were worth approximately 150x dollars or more. B when selling her stock retained the books of the corporation and has since refused to surrender them. C, as sole owner of the corporation's capital stock, apparently conducted the business more or less as his own individual business and kept very incomplete corporate records. When disposing of his stock in the corporation to D and E, he turned over to them the corporation's stock book, stock ledger, and corporate seal, and a statement showing the names of the corporation's debtors and creditors and the amounts due and payable. None of the account books, with the exception of a cash book, were turned over to the purchasers of the stock, and the corporation is not now in possession of sufficient records to clearly establish its statutory invested capital.

The Unit in its final audit of the appellant company's return for 1917, established a statutory invested capital as of the beginning of that year on the following basis:



Capital stock.....	50x dollars.
Surplus (undivided profits).....	85x dollars.
	<hr/>
	135x dollars.
Less 1916 income tax prorated.....	x dollars.
	<hr/>
Adjusted invested capital.....	134x dollars.

No consideration was given to the fact that at the time the business was incorporated the value of the assets taken over by the corporation in exchange for its stock was greater than the par value of the stock issued therefor.

Article 63 of Regulations 41 provides that—

Where it can be shown by evidence satisfactory to the Commissioner of Internal Revenue that tangible property has been conveyed to a corporation or partnership by gift or at a value, accurately ascertainable or definitely known as at the date of the conveyance, clearly and substantially in excess of the cash or the par value of the stock or shares paid therefor, then the amount of the excess shall be deemed to be paid in surplus. \* \* \*

It is clearly evident from the records in the case that tangible property of a value substantially in excess of the par value of the stock paid therefor was conveyed by B to the M Company and that the corporation would be entitled to an allowance of paid-in surplus if it were now in possession of records showing the actual cash value of the tangible property at the time of conveyance. However, such records are not now available nor are there any records available from which a complete history of the corporation's invested capital from time of incorporation to the beginning of 1917 may be obtained and the amount of statutory invested capital allowable to the corporation for that year clearly established.

In view of the foregoing the Committee recommends that the action of the Income Tax Unit in disallowing a deduction of 15x dollars claimed by the M Company for the year 1917 to cover depreciation in the value of liquor license be sustained, and that the corporation be granted assessment of excess profits tax for the year 1917 under the provisions of section 210 of the Revenue Act of 1917.

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I ('22)-11-147; L. O. 1090

### Revenue Act of 1918.

1. The phrase "abnormal conditions affecting the capital or income of the corporation" is defined to include the following: (a) Where a corporation is placed in a position of substantial inequality because of the time or manner of organization; (b) where the capital employed, although a material income-producing factor, is very small, or in large part borrowed; (c) where there is excluded from invested capital under section 326 intangible assets of recognized value and substantial in amount which have been developed by the taxpayer (in view of the specific limitations upon the admission of intangibles into invested capital contained in sec. 326 of the Act applications for assessments under sec. 328 upon this ground should be carefully scrutinized and the application denied where its allowance would result in defeating the avowed purpose of the limitations contained in sec. 326); (d) where the net income for the year is abnormally high, due to realization in one year of income earned during a period of years; (e) where extraordinary gains are derived from the sale of property where its principal value has been demonstrated by prospecting or exploration; and (f) where proper recognition can not be made for amortization, obsolescence, or exceptional depletion due to the World War.

2. Where application is made under section 327(d) for assessment under section 328 of the Act of 1918, the abnormal conditions affecting the capital or income of the taxpayer must be established by proof. Abnormal conditions affecting capital or income in the present case have been established.

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3. The term "exceptional hardships," as used in section 327(d) of the Revenue Act of 1918, means the hardship of inequality evidenced by gross disproportion between the tax computed without the benefit of sections 327 and 328 and the tax computed by reference to the representative corporations specified in section 328, but inequality alone is not sufficient to grant relief under section 328; the inequality must be due to abnormal conditions affecting capital or income.

4. In selecting corporations with which to compare the taxpayer in a given case, great care should be exercised, and only corporations which are truly representative should be used. The word "representative," as used in the Act, means "typical" or "symbolical," and the Act requires the comparatives used to be typical as near as may be in respect to capital employed, gross income, net income, profits per unit of business transacted, amount and rate of war and excess profits tax, and all other relevant facts and circumstances. The corporations used as comparatives must not only be in the same general line of business, but as nearly as possible representative in all the particulars mentioned in the Act. In the present case, comparatives Nos. 1 and 2 are not representative within the meaning of section 328 of the Revenue Act of 1918. Their use in this case creates and does not correct an inequality.

Reference is made to the claim filed by the M Company for the abatement of  $71\frac{1}{3}\%$  dollars excess profits taxes for the year 1918. The claim is based upon the application for assessment under sections 327 and 328 of the Act of 1918. The Unit allowed relief under the above sections, and after selecting comparatives provided for in the last paragraph of section 328, computed the tax thereunder and found the corporation entitled to an abatement in the sum of  $71\frac{1}{3}\%$  dollars and, in addition thereto, has suggested a refund of  $40\%$  dollars of the taxes already paid.

The question is whether the corporation is entitled to relief under these sections, and, if so, whether the proper comparatives have been used in computing the tax.

The M Company appears to have begun business about 1901 and to have organized under its present name in 1905 with a cash capital of  $60\%$  dollars. In 1909 it took over the assets of the O Company and the P Company and increased its capital stock to  $600\%$  dollars. Under the plan of reorganization the par value of the stock was \$100, and  $15\frac{3}{4}\%$  shares appear to have been issued for tangible assets and  $14\frac{1}{4}\%$  shares for intangible assets, making the total outstanding shares  $30\%$ .

In its early years and up until 1916 this corporation's earnings were small, and it was its policy to reinvest its earnings and surplus in plant property. From 1917 on its earnings have been very large, due no doubt in large part to war conditions. In 1918 its invested capital was over  $1,200\%$  dollars and its net income approximately  $700\%$  dollars.

Over  $200\%$  dollars written up on the books as good will has been disallowed as invested capital, and the company bases its claim for relief under sections 327 and 328 on the fact that it has spent large sums in experimental work, and that as a result thereof it has developed secret formulas for the manufacture of . . . , which gives it a practical monopoly in certain kinds of . . . . That none of the amounts spent in experimental and discovery work has been capitalized, and it now has valuable intangible property which is not shown in its invested capital, which by the proper method of bookkeeping should be so included, and that by reason thereof it is subject to an exceptional hardship when compared with other corporations in its class which have capitalized such expenditures.

In order to determine whether or not the corporation in question is entitled to relief under section 327 and 328 of the Act of 1918, and if so whether the proper comparatives have been used, it is necessary to refer to the Act and its history and examine the case and the comparatives used in the light



of the language of the Act. The sections of the Act in so far as material are as follows:

Sec. 327. That in the following cases the tax shall be determined as provided in section 328:

(a) Where the Commissioner is unable to determine the invested capital as provided in section 326;

(b) In the case of a foreign corporation;

(c) Where a mixed aggregate of tangible property and intangible property has been paid in for stock or for stock and bonds and the Commissioner is unable satisfactorily to determine the respective values of the several classes of property at the time of payment, or to distinguish the classes of property paid in for stock and for bonds, respectively;

(d) Where upon application by the corporation the Commissioner finds and so declares of record that the tax is determined without benefit of this section would, owing to abnormal conditions affecting the capital or income of the corporation, work upon the corporation an exceptional hardship evidenced by gross disproportion between the tax computed without benefit of this section and the tax computed by reference to the representative corporations specified in section 328. This subdivision shall not apply to any case (1) in which the tax (computed without benefit of this section) is high merely because the corporation earned within the taxable year a high rate of profits upon a normal invested capital, nor (2) in which 50 per centum or more of the gross income of the corporation for the taxable year (computed under section 233 of Title II) consists of gains, profits, commissions, or other income, derived on a cost-plus basis from a Government contract or contracts made between April 6, 1917, and November 11, 1918, both dates inclusive.

Sec. 328. (a) In the cases specified in section 327 the tax shall be the amount which bears the same ratio to the net income of the taxpayer (in excess of the specific exemption of \$3,000) for the taxable year, as the average tax of representative corporations engaged in a like or similar trade or business, bears to their average net income (in excess of the specific exemption of \$3,000) for such year. In the case of a foreign corporation the tax shall be computed without deducting the specific exemption of \$3,000 either for the taxpayer or the representative corporations.

In computing the tax under this section the Commissioner shall compare the taxpayer only with representative corporations whose invested capital can be satisfactorily determined under section 326 and which are, as nearly as may be, similarly circumstanced with respect to gross income, net income, profits per unit of business transacted and capital employed, the amount and rate of war profits or excess profits, and all other relevant facts and circumstances.

The provisions of the bill as first introduced in the House of Representatives were very different from the Act as it finally passed. Section 327 as originally introduced was as follows:

(a) That in the following cases the invested capital shall be determined as provided in subdivision (b) of this section; (1) where the Commissioner is unable satisfactorily to determine the invested capital as provided in section 326; or (2) where a mixed aggregate of tangible property and intangible property has been paid in for stock or for stock and bonds and the Commissioner is unable satisfactorily to determine the respective values of the several classes of property at the time of payment, or to distinguish the classes of property paid in for stock and for bonds, respectively; or (3) where capital is a material income-producing factor, but where, because of the fact that the capital employed is in large part borrowed, there is no invested capital or the invested capital is materially disproportionate to the net income as compared with representative corporations engaged in a like or similar trade or business. This section shall not apply in the case of a corporation 50 per centum or more of whose gross income (as defined in section 213 for income tax purposes) consists of gain, profits or commissions derived from Government contracts, unless the Commissioner is satisfied that such corporation is overcapitalized.

(b) In the cases specified in subdivision (a) the invested capital shall be the amount which bears the same ratio to the net income of the corporation for the taxable year as the average invested capital for the taxable year of representative corporations engaged in a like or similar trade or business bears to their average net income for such year.

After much discussion, the bill was amended, passed the House, and was transferred to the Senate. When section 327 passed the Senate it read as follows:

That in the following cases the tax shall be determined as provided in section 328:

(a) Where the Commissioner is unable (satisfactorily) to determine the invested capital as provided in section 326;

(b) In the case of a foreign corporation;

(c) Where a mixed aggregate of tangible property and intangible property has been paid in for stock or for stock and bonds and the Commissioner is unable satisfactorily to determine the respective values of the several classes of property at the time of payment, or to distinguish the classes of property paid in for stock and for bonds, respectively;

(d) Where, as compared with representative corporations, engaged in a like or similar trade or business, the taxpayer would (under section 326) be placed in a position of substantial inequality, because of the time or manner of organization, or because the actual value of the assets on March 1, 1913, was substantially in excess of the amount at which such assets would be valued for the purpose of computing invested capital under the provisions of section 326;

(e) Where the invested capital is materially disproportionate to the net income as compared with representative corporations engaged in a like or similar trade or business because:

1. The capital employed, although a material income-producing factor, is very small or is in large part borrowed;

2. There are excluded from the invested capital as computed under the provisions of section 326, intangible assets of recognized and substantial value built up or developed by the taxpayer;

3. The net income for the taxable year is abnormally high due to the realization in one year of (a) gains, profits, or income earned or accrued during a period of years, or (b) extraordinary gains or profits derived from the sale of property the principal value of which has been demonstrated by prospecting or exploration and discovery work done by the taxpayer. When the tax is determined under this paragraph proper allowance shall be made for the taxes which would have been payable in prior years if the gains, profits, or income earned or accrued in such years has been taxed at the rates then applicable;

4. Proper recognition or allowance can not be made for amortization, obsolescence, or exceptional depletion due to the present war, or to the necessity in connection with the present war of providing plant which will not be wanted for the purpose of the trade or business after the termination of the war.

In the conference committee, composed of House and Senate members, the section was again very materially altered, and was finally passed in the form in which it is now contained in the Act.

Mr. Kitchin, who was in charge of the bill in the House and who was a member of the committee composed of House and Senate members, in his report from the committee to the House referred to the changes made in the Senate and in the conference committee as follows:

The House bill in the so-called relief provisions provided that in *certain specified cases* the invested capital of a corporation shall be the amount which bears the same ratio to the net income of the corporation for the taxable year as the average invested capital for the taxable year of representative corporations engaged in a like or similar trade or business bears to their average net income for such year.

The Senate amendment *increases the classes of cases* in which the tax is to be fixed by reference to the experience of representative corporations; included therein all foreign corporations, and provides that in such cases *the tax shall be* the amount which bears the same ratio to the net income of the taxpayer for the taxable year *as the average tax* of representative corporations engaged in a like or similar trade or business bears to their average net income for such years.

The House recedes with amendments:

(1) Making clerical changes;

(2) *Consolidating a number of separate classes of cases differentiated in the Senate amendment into a single class of cases in which upon application by the corporation \* \* \**

and continues in the same language of the Act.

Mr. Kitchin later, in a speech before the House, stated what the committee intended by the use of the language used in section 327. After reading paragraph (d) of section 327, he proceeded as follows:

The bill provides that in the *cases specified in section 327* the tax shall be an amount which bears the same proportion to the net income of the taxpayer, in excess of the specific exemption of \$3,000, for the taxable year as the average tax of representative corporations engaged in a like or similar trade or business bears to their average net income, in excess of the specific exemption of \$3,000 for such year. Under the specific provisions no official had any particular responsibility, and *one could take any case he desired, whether it was an*



*exceptional hardship or not*, and make application that the tax should be computed on the basis of representative corporations.

The conferees, as I said a while ago, as a matter of safety to the Government, without doing any injustice to the taxpayer, in case he is actually entitled to relief, provide that the taxpayer, in order to get relief under this representative corporation section, must apply to the Commissioner and must show to the Commissioner that it is an exceptional hardship; not that he is making an exceedingly large profit on invested capital and therefore his tax is exceedingly large, but it must be an exceptional hardship owing to the peculiar and exceptional conditions surrounding the taxpayer's business, income, invested capital, and so forth; and the Commissioner must find, and so declare of record, that the case is one of exceptional hardship before it can be considered under section 328.

This provision gives a taxpayer only that to which he is entitled, because he ought not to have relief unless, owing to the peculiar situation of his business or capital or income or something, the payment of the tax would be an exceptional hardship upon him without the benefit of the relief provision.

This language leaves a very vague and indefinite idea in the mind as to what was intended by "abnormal condition" but it is a very definite statement that no relief is to be given under the section unless there is "exceptional hardship." The language indicates also that it is not an "exceedingly large tax" to be paid upon "exceedingly large profits" which gives the taxpayer right to relief under the section, but "exceptional hardship" due "to the peculiar situation" of the "business or capital or income or something" so that "the payment of the tax would be an exceptional hardship \* \* \* without the benefit of this section."

Senator Simmons, of North Carolina, who was in charge of the bill in the Senate, in his speech on Tuesday, December 10, 1918, Congressional Record, page 529, had the following to say in connection with relief measures:

We have also recommended a series of relief amendments relating to amortization, depletion, and shrinkage in inventories, which, if ratified by the Senate and not eliminated in conference, I think will answer to a very large extent the criticisms of the present law and correct many discriminations and inequalities which have confronted the department in the administration of the existing law. In addition, the committee has prepared a general amendment which we have been in the habit in the committee of speaking of as the relief amendment, authorizing the Commissioner to classify in groups certain exceptional cases which seemed to require special treatment to safeguard the taxpayer against injustice. Every corporation which brings itself within the provisions of these classifications is given the benefit, in computing its deductions, of the like or "similar business" section of the bill; that is to say, it will be entitled to the same percentage of deductions that representative concerns in the same line of business are found to be entitled to.

Senator Penrose, in a speech delivered Wednesday, February 12, 1919, after the meeting of the conferees of the Senate and House, made the following statement in connection with the relief provisions:

A similar change was made in the conference in connection with the war profits credit or deduction for new corporations; that is, corporations organized after January 1, 1913. The House gave new corporations a deduction of 10 per cent of their invested capital for the taxable year. The Senate liberalized this and made the deduction of new corporations the same percentage of their invested capital for the taxable year as was earned by corporations in the same general class of trade or business during the prewar period. The conferees adopted the Senate method, but excepted newly organized subsidiaries and corporations whose principal income is derived from war contracts. Similar action was taken with respect to the so-called relief provisions, which permit the profits tax in any case of exceptional hardship to be fixed by reference to the experience of representative concerns. This amendment, to my mind, is a most admirable one. The Senate greatly increased the classes of cases entitled to this relief. The conferees amalgamated all these classes into a single general class, but denied the relief to corporations whose principal income consists of profits derived on a cost-plus basis from war contracts. Relief also was granted to certain partnerships doing business with invested capital which reorganize as corporations prior to July 1, 1919. Such partnerships are authorized to pay income taxes, profits taxes, and capital-stock taxes for 1918 as corporations in lieu of the income taxes to which, under existing law, the members of the partnership would be liable. This extends immediate relief to a class of partnerships in which the exigencies of business require most

of the profits to be reinvested and which, under existing law, have been taxed much more severely than their competitors organized in the corporate form.

This amendment, Mr. President, put into the bill at the last hour, furnishes, in my opinion, a striking illustration of the relief provisions abounding in the measure. There was a particular case, typical of many others, in which it was discovered that some seven or eight hundred thousand dollars of taxes would have had to have been paid by a certain partnership in excess of that required under the corporate form, thereby involving a most *rank and indefensible discrimination* between one concern as a partnership and, perchance, a competitor as a corporation. This amendment was put in giving such a partnership the option of becoming incorporated and paying the profits taxes as a corporation. I only refer to this as a fine illustration, to my mind, of very many similar provisions put in the bill to *correct inequalities*; not put in to favor any individual, but to *relieve the hardship of inequality* which the legislator can not defend or explain to the injured taxpayer.

The above-quoted statements indicate that Congress intended to retain the relief provisions of the Senate in the bill as finally passed, but that it intended to consolidate all the provisions into one general class. The Senate greatly increased the classes of cases entitled to this relief, and the conferees amalgamated all these classes into a single general class. A better idea may be gained of the relief intended, therefore, when a comparison is made of the bill as it passed the House, as it passed the Senate, and as it finally passed after conference. If all the classes of cases which were embodied in the bill as it passed the Senate were "amalgamated" or "consolidated" into one general class, we receive some idea of what was intended by the use of the phrase "abnormal conditions affecting the capital or income of the corporation" by referring to the bill as it passed the Senate. By this reference the phrase may be defined to include the following: (a) Where a corporation is placed in a position of substantial inequality because of the time or manner of organization; (b) where the capital employed, although a material income-producing factor, is very small or in large part borrowed; (c) where there is excluded from invested capital under section 326 intangible assets of recognized and substantial value developed by the taxpayer (in view of the specific limitations placed upon the admission of intangibles into invested capital contained in section 326 of the Act, applications for assessment under 328 for this reason should be closely scrutinized and the application denied where allowance of the application would result in defeating the avowed purpose of the limitations contained in sec. 326); (d) where the net income for the year is abnormally high, due to realization in one year of income earned during a period of years; (e) where extraordinary gains are derived from the sale of property where its principal value has been demonstrated by prospecting or exploration; and (f) where proper recognition can not be made for amortization, obsolescence, or exceptional depletion due to the World War. One other, "where the invested capital is materially disproportionate to the net income," was included in the Senate bill but was excluded by the conferees by the use of the following: "This subdivision shall not apply to any case (1) in which the tax (computed without benefit of this section) is high merely because the corporation earned within the taxable year a high rate of profit upon a normal invested capital." This provision was inserted in the Act by the conferees and was evidently for the purpose of restricting the section to a smaller class of cases, because without this provision the Act as amended in the Senate would clearly have applied to such a case.

The phrase "exceptional hardship" is defined in the above quotations more clearly than the provision as to "abnormal conditions." Senator Simmons, in speaking of "certain exceptional cases," used the words "*to safeguard the taxpayer against injustice*," and Senator Penrose in speaking of the relief provisions in the bill used more emphatic language, such as "to



correst inequalities” and “most rank and indefensible discrimination,” and directly defines what he means by “exceptional hardship” as the “*hardship of inequality which the legislator can not defend or explain to the injured taxpayer.*” The plan evidently was to give the Commissioner the power to administer the excess profits tax law with as few inequalities as possible to taxpayers falling in the same class. If, due to abnormal conditions, an exceptional hardship of inequality appears to have been imposed upon any taxpayer by computing its invested capital under section 326, such taxpayer has the right to appeal to the Commissioner and show that it is having to pay a higher rate of tax than other corporations which are similarly circumstanced and ask that it be allowed to pay a tax equal to the average rate of tax paid by other corporations which are in its class and similarly circumstanced. Such a taxpayer, to be entitled to the provisions of section 328, must be able to show that when compared to other corporations which are similarly circumstanced with respect to gross income, net income, profits per unit of business transacted and capital employed, the rate of war profits or excess profits tax imposed upon it is higher than the rate imposed upon such other corporations. However, when it has shown the inequality, before it is entitled to the relief sought it must go further and show that the inequality is due not merely to large profits earned upon a normal capital, but to abnormal conditions affecting its income or invested capital.

The thought in the minds of those in charge of the bill was centered upon preventing inequalities and unjust discriminations. If the corporation's tax is high merely because it made large profits upon a normal invested capital, no relief is to be granted. If, however, owing to some abnormal condition affecting its business it is compelled to pay a higher rate of tax than other corporations in its class, then it may show that it is under the “hardship of inequality” and gain relief under sections 327 and 328. The power placed in the hands of the Commissioner is first to determine whether the “hardship of inequality” exists, and if it does and it is due to abnormal conditions, he is to average the taxpayer's tax with comparatives selected according to the Act.

Manifestly, if the *discriminations* referred to in the debates are to be avoided, the greatest care should be exercised in selecting the comparatives. It is easy, without effort or intent, to select comparatives so differently circumstanced as to cause rather than correct glaring inequalities between taxpayers of the same class. Granting one taxpayer relief under section 328 and comparing it with corporations which are not similarly circumstanced in all of the particulars mentioned in the Act, and giving it a lower rate of tax than corporations so circumstanced, is creating, not correcting, the “hardship of inequality.” Congress has provided that the comparatives shall be representative corporations similarly circumstanced as to gross income, net income, and profits per unit of business transacted, “the amount and rate of excess profits and capital employed and all other relevant facts and circumstances,” and that the taxpayer seeking such relief shall be compared *only* with such representative corporations. The term “capital employed” as used in section 328, as applied to the taxpayer, means total capital employed as distinguished from statutory invested capital. The word “representative,” as used in this section, means “typical” or “symbolical,” and the Act requires that the comparatives used be as nearly as possible representative in all the particulars mentioned therein, and where it is not possible to find comparatives which are representative in all the particulars named in the Act it should be kept in mind that the intention of Congress was to equalize taxes rather than reduce any particular taxpayer's taxes.

It does not appear to this office that the comparatives used in the present case meet with the requirements of the Act. Comparatives 3, 4, 5, and 6 appear to have been well taken. These comparatives are all located in . . . . ., their capital employed is very nearly the capital of the claimant, and while their gross sales are less, their net income compares favorably with that of the taxpayer. Their ordinary expense accounts, repairs, interest and taxes, and rate of excess profits compare favorably with the taxpayer's. The taxpayer's rate of tax computed under section 326 is a little higher than any one of them, but the tax rate of three of these comparatives ranges from . . . . . per cent to . . . . . per cent. The other one is below . . . . . per cent. The taxpayer's rate is . . . . . per cent.

Comparatives 1 and 2, however, do not compare with the taxpayer in hardly any particular, and are so unlike the taxpayer that the impression might be gained that they have been used for no other purpose than to reduce the taxpayer's rate of tax. Their invested capital is approximately four times as large as the invested capital of the taxpayer; their gross income is nearly twice as much; and their expense accounts compare in no particular favorably with the taxpayer. The item of repairs alone should cause these comparatives to be closely scrutinized. The taxpayer's repairs are considerably less than 200x dollars. Each of the repair accounts of comparatives 1 and 2 is nearly 700x dollars, or over three times as much as the taxpayer's. Their taxes and interest accounts are much larger, and in comparative 2 nearly thirty times as large as the taxpayer's. Their excess profits tax rate is only one-third to one-half as high as the other comparatives. They are not similarly circumstanced with respect to gross income, net income, profits per unit of business transacted, as to capital employed, as to the amount and rate of war profits or excess profits, nor in any other particular. *They produce, and do not correct, an inequality.* When used in this case, they reduce the taxpayer's rate of tax to . . . . . per cent, while the comparatives which are similarly circumstanced to the taxpayer must pay their taxes at rates ranging from . . . . . per cent to . . . . . per cent.

Senator Smoot, when he was speaking on the subject on the floor of the Senate, December 14, 1918 (Congressional Record, p. 666), foresaw what might happen if these sections were not administered with great care, and said:

Mr. President, those are the relief provisions as provided in the bill. Some of them are very sweeping in their scope, and if not *administered by the department in absolute fairness will work an unjust discrimination against the business of the country.* I want Senators to know that in these provisions there is placed in the hands of the Commissioner of Internal Revenue or the Secretary of the Treasury, as the case may be, a power that has never been granted to department officials before. If exercised wisely it will be a relief to the institutions of the country, and many of them will need it, but if exercised unjustly or unwisely *there will be a frightful discrimination between business concerns and industries of the country.*

From the foregoing it follows that the taxpayer in this case has established an abnormal condition within the meaning of section 327 of the Revenue Act of 1918 by showing that it has developed in connection with its business intangible assets of recognized value and substantial in amount which are excluded from its invested capital under section 326 of the Act, and is therefore entitled to relief under the provisions of sections 327 and 328 of the Revenue Act of 1918, if comparatives selected in accordance with the provisions of section 328 show the existence of an exceptional hardship as defined herein; that comparatives Nos. 1 and 2 should be eliminated from the comparative data and other comparatives selected which meet the requirements of the Act.

CARL A. MAPES,  
Solicitor of Internal Revenue.



I('22)-14-205: A. R. R. 845

**Revenue Act of 1918—Sections 327 and 328.**

Recommended, in the appeal of the M Company, that the action of the Income Tax Unit in denying assessment under the provisions of sections 327 and 328 of the Revenue Act of 1918 be affirmed, and, accordingly, that the appeal of the taxpayer be denied.

The Committee has had under consideration the appeal of the M Company from the action of the Income Tax Unit in denying application for assessment of the 1919 tax under the provisions of sections 327 and 328 of the Revenue Act of 1918.

The attorneys for the taxpayer contend that the contracts entered into between the M Company and the United States Government are not "cost plus" contracts within the meaning of that term as used in section 327 of the Revenue Act of 1918.

Inasmuch as the question presented is one of law rather than of fact, the entire file was referred to the Solicitor with request for an opinion. Under date of February 2, 1922, the Committee is in receipt of an opinion from the Solicitor, which reads as follows:

The pertinent provisions of the contract may be summarized as follows:

1. The contractor agreed to construct for the United States a manufacturing plant to consist of nine sections of the aggregate capacity of  $y$  pounds per day of 24 hours, capable of being operated for 27 days per month. The total cost was estimated at  $75x$  dollars. *The United States agreed to reimburse the contractor for all costs and expenses of every character and description incurred or made in connection with the construction and equipment of the plant.*

2. The contractor agreed upon the completion of each section of the plant to operate it and to do all things necessary or convenient in this connection, including the purchase and procurement of all necessary materials and labor therefor. *The United States agreed to bear all the cost and expenditures of every character and description incurred or made in connection with the operation of the plant or any part thereof.* In addition to reimbursement by the United States for all costs and expenditures incurred in operating the plant, or any part thereof, it was agreed that the United States should pay the contractor  $z$  cents per pound for each and every pound of the product delivered and accepted under the contract; and in addition thereto, one-half of the difference, if any, between the estimated cost of producing each pound, determined in accordance with the provisions of the contract, and the actual cost of production, as ascertained in paragraph (a) of such article, where such actual cost was less than the estimated cost so determined.

It will be noted that there was to be paid to the contractor as a guaranteed fixed profit  $z$  cents per pound for the product delivered and accepted and that reimbursement was to be made by the United States to the contractor for "all costs and expenditures of every character and description."

For the purpose of determining the amount of additional compensation, if any, to be paid over and above the guaranteed profit of  $z$  cents per pound of the product delivered and accepted, one article sets forth an estimated price list per pound of five component materials. Upon the basis of this price list estimated base prices per pound were fixed for five grades of the product to be manufactured under the contract (that is, an estimated cost of manufacturing a pound of product of the respective grades). Of the several grades specified only one grade has been manufactured at the time of the suspension of work under the contract after the signing of the armistice, of which approximately  $39\frac{1}{2}y$  pounds were manufactured. The estimated price of this grade was originally fixed at  $12.7z$  cents per pound. It was provided, however, that if the cost of any of the component materials should so change as to increase or decrease the actual cost of the product, then the estimated price per pound should be increased or decreased accordingly. As stated, this estimated price was fixed only for the purpose of measuring the additional profit to be paid to the contractor, if it should be able to produce the product at an actual cost less than the estimated price so fixed.

Paragraph (a) of article — provided that the actual cost per pound of the product should be all the costs and expenditures incurred or made in operation, excluding, however, (1) the cost of placing finished product in storehouses, (2) the cost of boxes, and (3) the expense of maintaining guards at the plant. These latter costs, although not included in the computation for ascertaining the actual cost of the product for the purpose stated, were nevertheless a part of the actual cost of operation to be borne by the Government.



In the actual working out of the contract it was necessary to make an adjustment of the estimated price of 12.7% cents per pound for the product delivered and accepted, because the contractor was compelled to pay higher prices for certain component materials than the estimated prices specified therefor. The estimated price was, therefore, increased to approximately 13.1% cents per pound. The actual cost per pound of the product manufactured was 11.6% cents per pound, resulting in a so-called saving of 1.5% cents per pound under the readjusted base price of 13.1% cents per pound. The actual cost of producing such product upon this basis was approximately  $1\frac{3}{4}\%$  dollars less than the estimated cost upon the basis of the readjusted estimated base price per pound. Pursuant to the terms of the contract, the contractor became entitled thereby to one-half of the so-called saving, or  $\frac{3}{8}\%$  dollars, which, as stated, was in addition to the guaranteed profit of  $\frac{1}{2}\%$  cents per pound for each pound of the product delivered and accepted.

The taxpayer has applied for the assessment of its 1919 taxes under section 328 of the Revenue Act of 1918. Section 327 of the Revenue Act of 1918 provides in part as follows: "Sec. 327. That in the following cases the tax shall be determined as provided in section 328:

(d) Where upon application by the corporation the Commissioner finds and so declares of record that the tax if determined without the benefit of this section would, owing to abnormal conditions affecting the capital or income of the corporation, work upon the corporation an exceptional hardship evidenced by gross disproportion between the tax computed without benefit of this section and the tax computed by reference to the representative corporations specified in section 328. This subdivision shall not apply to any case \* \* \* (2) in which 50 per centum of the gross income of the corporation for the taxable year (computed under section 233 of Title II) consists of gains, profits, commissions or other income derived on a cost-plus basis from a Government contract or contracts made between April 6, 1917, and November 11, 1918, both dates inclusive."

The contract in question was made on March —, 1918, and is within the time prescribed by clause (2) of subdivision (d) of the section quoted.

The question for determination is whether the income from the product manufactured under the contract here in question is derived on a cost plus basis. Words in a statute are to be construed in their ordinary and generally accepted sense, unless the context in which they are used implies that a different meaning was intended. On behalf of the taxpayer it has been contended that the phrase is equivalent in meaning to the phrase "income derived on a cost basis," that is to say that income derived on a cost basis must bear some relation to total cost, the amount thereof being arrived at by a computation based upon the amount of such total cost. In other words, that cost is the measure of income derived, computed at some rate upon the basis of the total cost. It has, therefore, been contended that the application of the phrase "income derived on a cost-plus basis" must be limited to income derived upon a cost plus a percentage basis from a Government contract within the time prescribed by the statute.

In my opinion "income derived on a cost-plus basis from a Government contract" means simply income derived from such a contract wherein the method of compensating the contractor is by way of reimbursing him the total actual cost of the work done or the article furnished and the payment to such contractor in addition thereto of a guaranteed profit, consisting either of (1) a fixed percentage of total cost, (2) a fixed profit of a definite sum agreed upon at the time of the closing of the contract, or (3) such fixed profit of a definite sum plus a percentage of any so-called saving effected by the contractor by the doing of such work or the production of such article at a cost below an agreed estimated cost of production fixed at the time of the closing of the contract. In common usage the term "cost-plus basis" has been used merely as a means of distinction from the term "lump-sum basis," which is a method of compensation whereby the parties agree that the contractor will do certain work at an agreed total cost to the owner of a lump or fixed sum fixed at the time of the closing of the contract. See Kester, "Accounting, Theory and Practice," volume 3, pages 318 and 319. See also Crowell, "Government War Contracts," volume 25, "Preliminary Economic Studies of the War," published by the Carnegie Endowment for International Peace. In prewar days the "cost-plus basis" of contracting was used in order to assure good workmanship and good materials in connection with building contracts and to prevent the restricting of costs by the contractor. It consisted simply of the assumption of costs by the owner and the payment of a fee as the contractor's compensation, determined in either of the three ways mentioned above. During the recent war it was used in Government war contracting where speed and a quantity production were required and where there were no ready estimates at hand to enable the parties to fix a lump-sum contract-price. It was also used in letting contracts to some contractors of proven ability, but who could not finance operations upon as large a scale as the Government required. The "cost-plus basis" of contracting has, therefore, been used as indicating a method of making compensation rather than as a basis for the determination of the amount of compensation to be paid. Such compensation may or may



not be computed upon the basis of or in direct relation to cost, but in either case it satisfies the term "plus." This interpretation appears to be in accord with the common understanding of the term "cost-plus basis" by the governmental departments charged with war contracting, as appears from the recommendations of the Interdepartmental Cost Conference held on July 31, 1917. (See full reprint of such recommendations in Nicholson & Rohrbach on Cost Accounting, p. 488, et seq.) Accordingly, this office holds that the "cost-plus basis" of contracting within the meaning of the statute applies to those cases wherein the contractor is to be reimbursed the actual cost of operations and is to be paid in addition (or "plus") an assured profit, determined by any of the methods above mentioned, whereby the burden of the cost of production is put upon the Government.

As appears above, the method of compensation agreed upon by the parties to the contract here considered consisted of a reimbursement to the contractor of its total actual cost of operations and the payment in addition thereto of a fixed profit of a definite sum for each and every pound of product delivered and accepted, with a provision for the payment of an additional profit of 50 per cent of a so-called saving in case the contractor produced the product at an actual cost of production in an amount less than the estimated cost of production as determined under the contract. Income derived upon this basis or method of compensation is "income derived on a cost-plus basis."

In view of the foregoing opinion of the Solicitor, in which the Committee concurs, it is recommended that the action of the Income Tax Unit in rejecting the corporation's application for assessment of the profits tax for 1919 under the provisions of sections 327 and 328 of the Revenue Act of 1918 be affirmed, and accordingly that the appeal of the taxpayer be denied, inasmuch as 50 per cent or more of the gross income of the corporation for the taxable year consists of gains, profits, commissions, or other income derived on a cost-plus basis from a Government contract or contracts made between April 6, 1917, and November 11, 1918, both dates inclusive.

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I (22)-47-606; L.O. 1109.

### Excess-Profits Tax—Sections 327 and 328, Revenue Act of 1918.

1. The phrase "abnormal conditions affecting the capital or income of the corporation" includes the following cases, among others: (a) Where a corporation is placed in a position of substantial inequality because of the time or manner of organization; (b) where the capital employed, although a material income-producing factor, is very small or is in a large part borrowed; (c) where there are excluded from invested capital computed under section 326 intangible assets of recognized value and substantial in amount, built up or developed by the taxpayer; (d) where the net income for the year is abnormally high, due to the realization in one year of (1) income earned during a period of years, or (2) extraordinary profit derived from the sale of property the principal value of which has been demonstrated by prospecting or exploration and discovery work done by the taxpayer, or (3) gain derived in one year from the sale of property the increase in value of which had accrued over a period of years; (e) where proper recognition or allowance can not be made for amortization, obsolescence, or exceptional depletion due to the World War.

2. Where application is made under section 327(d) for assessment under section 328 of the Act of 1918, the abnormal conditions affecting the capital or income of the taxpayer must be established by evidence. Abnormal conditions affecting capital or income in the present case have been established.

3. The term "exceptional hardship," as used in section 327(d) of the Revenue Act of 1918, means the hardship of inequality evidenced by gross disproportion between the tax computed without the benefits of sections 327 and 328 and the tax computed by reference to the representative corporations specified in section 328, but inequality alone is not sufficient to entitle a taxpayer to assessment under section 328; the inequality must be due to abnormal conditions affecting the capital or income.

4. In selecting corporations with which to compare the taxpayer in a given case, great care should be exercised and only corporations which are truly representative should be used. The word "representative," as used in the Act, means "typical" or "average," and the Act requires the comparatives used to be representative and to be similarly circumstanced as nearly as may be in respect to gross income, net income, profits per unit of business transacted and capital employed, amount and rate of war profits or excess profits, and all other relevant facts and circumstances. The corporations used as comparatives must not only be engaged in a like or similar trade or business, but as nearly as possible

similarly circumstanced in all the particulars mentioned in the Act. In the present case the comparatives selected comply with the provisions of the statute.

5. Law Opinion 1090 (C. B. I-1, p. 383) [Sec. 327. Art. 901-31, herein] is hereby revoked.

Due to the difficulty which has been experienced in interpreting and applying Law Opinion 1090, it appears advisable to reconsider that opinion. Furthermore, it is necessary to give further consideration to the question of what constitutes proper comparatives for the M Company, the case which was under consideration in Law Opinion 1090.

The facts in the case of the M Company are as follows:

The M Company appears to have begun business about 1901 and to have organized under its present name in 1905, with a cash capital of 60x dollars. In 1909 it took over the assets of the O Company and the P Company and increased its capital stock to 600x dollars. Under the reorganization, 15 $\frac{3}{4}$ y shares of stock of the par value of \$100 were issued for tangible assets, and 14 $\frac{1}{4}$ y shares of the same par value for intangible assets. Until 1916 the corporation's earnings were small, and it was its policy to reinvest its earnings and surplus in plant property. Since 1917 the company's earnings have been very large, due, no doubt, in a large part to war conditions. In 1918, its statutory invested capital was over \$1200x dollars and its net income approximately 700x dollars.

The company has made claim for the abatement of 71.3x dollars excess-profits taxes for the year 1918, the claim being based upon an application for assessment under sections 327 and 328 of the Revenue Act of 1918. The Income Tax Unit allowed relief under the above sections and computed the tax by means of comparatives under section 328, and found the corporation entitled to an abatement in the sum of 71.3x dollars and a refund in the amount of 40x dollars.

The claim of the taxpayer for assessment under sections 327 and 328 is based on the fact that it has spent large sums in experimental work and that as a result thereof it has developed secret formulas which give it a practical monopoly in the manufacture of certain types of high-grade —; that none of the amounts spent in experimental and discovery work has been capitalized; that it now has valuable intangible property which is not reflected in its invested capital, and that by reason thereof it is subject to an exceptional hardship when compared with other corporations in its class which have capitalized such expenditures.

The question presented is whether the M Company is entitled to relief under the provisions of sections 327 and 328, and if so, whether the comparatives used in computing the tax under section 328 are proper.

The pertinent provisions of the Revenue Act of 1918 follow:

Sec. 327. That in the following cases the tax shall be determined as provided in section 328:

(a) Where the Commissioner is unable to determine the invested capital as provided in section 326;

(b) In the case of a foreign corporation;

(c) Where a mixed aggregate of tangible property and intangible property has been paid in for stock or for stock and bonds and the Commissioner is unable to satisfactorily to determine the respective values of the several classes of property at the time of payment, or to distinguish the classes of property paid in for stock and for bonds, respectively;

(d) Where upon application by the corporation the Commissioner finds and so declares of record that the tax if determined without benefit of this section would, owing to abnormal conditions affecting the capital or income of the corporation, work upon the corporation an exceptional hardship evidenced by gross disproportion between the tax computed without benefit of this section and the tax computed by reference to the representative corporations specified in section 328. This subdivision shall not apply to any case (1) in which the tax (computed without benefit of this section) is high merely because the corporation earned within the taxable year a high rate of profit upon a normal invested capital, nor (2) in which



50 per centum or more of the gross income of the corporation for the taxable year (computed under section 233 of Title 11) consists of gains, profits, commissions, or other income, derived on a cost-plus basis from a Government contract or contracts made between April 6, 1917, and November 11, 1918, both dates inclusive.

Sec. 328. (a) In the cases specified in section 327 the tax shall be the amount which bears the same ratio to the net income of the taxpayer (in excess of the specific exemption of \$3,000) for the taxable year, as the average tax of representative corporations engaged in a like or similar trade or business, bears to their average net income (in excess of the specific exemption of \$3,000) for such year. In the case of a foreign corporation the tax shall be computed without deducting the specific exemption of \$3,000 either for the taxpayer or the representative corporations.

In computing the tax under this section the Commissioner shall compare the taxpayer only with representative corporations whose invested capital can be satisfactorily determined under section 326 and which are, as nearly as may be, similarly circumstanced with respect to gross income, net income, profits per unit of business transacted and capital employed, the amount and rate of war profits or excess profits, and all other relevant facts and circumstances.

While it is manifestly impossible to enumerate all the classes of cases in which there exists an abnormality affecting the capital or income of a corporation which may entitle the corporation to assessment under section 328, it is thought advisable to set out some of the more usual conditions or circumstances which result in such an abnormality as may form the basis for assessment under that section. The following enumeration is by no means an exclusive one; no attempt is made to enumerate all the conditions or circumstances which result in an abnormality under the statute. However, a statement of the typical and usual cases in which an abnormality exists affecting income or capital is of value in that it shows the type of cases contemplated by the statute and answers some of the questions which most often arise regarding the construction and application of the section of the statute. It should be borne in mind, however, in determining a specific case whether there exists such an abnormality as to entitle the corporation to assessment under section 328, that sections 327 and 328 are obviously relief sections and should be construed and applied so as to carry into effect the clear intention of Congress.

It is my opinion that the following represent the typical and common cases in which there is present an abnormal condition affecting capital or income of a corporation: (1) Where a corporation is placed in a position of substantial inequality because of the time or manner of organization; (2) where the capital employed, although a material income-producing factor, is very small or is in a large part borrowed; (3) where there are excluded from invested capital computed under section 326 intangible assets, of recognized value and substantial in amount, built up or developed by the taxpayer; (4) where the net income for the year is abnormally high, due to the realization in one year of (a) income earned during a period of years, or (b) extraordinary profit derived from the sale of property the principal value of which has been demonstrated by prospecting or exploration and discovery work done by the taxpayer, or (c) gain derived in one year from the sale of property the increase in value of which had accrued over a period of years; and (5) where proper recognition or allowance can not be made for amortization, obsolescence, or exceptional depletion due to the World War.

The above alone, however, is not sufficient to entitle the taxpayer to the benefit of assessment under section 328. The circumstances outlined above must work upon the corporation an exceptional hardship, evidenced by gross disproportion between the tax computed without the benefit of sections 327 and 328 and the tax computed under section 328, in order that the taxpayer may be entitled to special relief. "Exceptional hardship," which is a prerequisite to assessment under section 328, must be evidenced by *gross*

*disproportion* between the tax computed without the benefit of the relief sections and the tax computed under section 328 by a comparison with representative corporations engaged in a like or similar trade or business and similarly circumstanced with the taxpayer as nearly as may be with respect to gross income, net income, profits per unit of business transacted and capital employed, the amount and rate of war profits or excess profits, and all other relevant facts and circumstances.

In determining whether a taxpayer is entitled to assessment under section 328 because of any of the reasons given above, the limitation contained in section 327 (d) should be constantly borne in mind. A taxpayer is not entitled to relief if its tax is high merely because it earned within the taxable year a high rate of profit upon a normal invested capital. The distinction between those cases in which the tax, computed without benefit of the relief provision, is exceptionally high because of abnormal conditions affecting invested capital or net income and those cases in which the tax is high merely because the corporation earned exceptionally high profits upon a normal invested capital, is an important one; in the first case, the corporation may be entitled to relief; in the second case, it is not entitled to relief.

Applying the above to the instant case, it is my opinion that the M Company is entitled to assessment under the provisions of section 328, since the tax, if determined without the benefit of the relief section, would, owing to the existence of an abnormal condition affecting the capital of the company, work upon the company an exceptional hardship evidenced by gross disproportion between the tax computed without benefit of the relief sections and the tax computed by reference to the representative corporations specified in section 328.

Under sections 327 and 328, where an abnormality exists affecting the net income or invested capital of the corporation, so that the corporation is entitled to special relief, the rate of tax of the corporation shall be based upon the average rate of tax of representative corporations engaged in a like or similar trade or business and similarly circumstanced as nearly as may be with the taxpayer. Representative corporations, within the meaning of this section, are the typical or average ones in that trade or business, as distinguished from the ones having peculiar characteristics. The intent of the section, therefore, is that the rate of tax of a corporation entitled to special relief shall be based upon the average rate of tax of the typical or average corporations in that trade or business which are similarly circumstanced, as nearly as may be, with the taxpayer. Great care should be exercised in the selection of these comparatives, because the granting of relief under Section 328 and the comparison with other corporations which are either not representative of the trade or business or not similarly circumstanced in all particulars specified in the Act, may create inequalities rather than correct them.

However, it must be recognized as a practical matter that it is not always, and in fact is seldom, possible to find comparatives representative of the trade or business which are similarly circumstanced with the taxpayer in all particulars specified in the Act. In fact, the statute expressly recognizes this fact by providing that the corporations with which the taxpayer entitled to special relief is compared must be similarly circumstanced "*as nearly as may be*" with respect to the various facts and circumstances specified.

These six comparatives given on the data sheet, I am advised, comprise the corporations representative of the same trade or business as the M Company, which are most similarly circumstanced with respect to the items specified in section 328, with the taxpayer. It may be noted, however, that



none of these six corporations is in exactly the same position as the taxpayer. The invested capital of comparatives 1 and 2 is approximately four times as large as the invested capital of the taxpayer; their gross income is nearly twice as large; their expense accounts do not compare favorably with that of the taxpayer. The amount of gross sales of comparative 6 is less than one-half that of the taxpayer. Its cost of goods sold is less than one-third that of the taxpayer, as is its expense account; its net income is considerably less than that of the taxpayer, while the proportion of its net income to gross sales is approximately twice that of the taxpayer. Furthermore, comparatives 3, 4, and 5, as may be seen, are circumstanced in many respects quite differently from the taxpayer. Thus, none of the six comparatives which are most nearly similarly circumstanced with the taxpayer is ideal. Nevertheless, the taxpayer is entitled to relief under section 328, and corporations must be used as comparatives which are similarly circumstanced as nearly as may be with the taxpayer. The six corporations used as comparatives in this case are those, I am advised, most similarly circumstanced with the taxpayer with respect to the items specified in section 328. Furthermore, the items of some which are dissimilar to the taxpayer are balanced by the corresponding items of the other comparatives, and the correctness of the result reached by the use of these comparatives is shown by the fact that the average obtained by grouping the six comparatives compares very closely with the taxpayer.

In the instant case the comparatives used are the ones most comparable to the taxpayer with respect to the items specified in section 328 and the average of these comparatives compares in every respect favorably with the taxpayer. It is my opinion, therefore, that the comparatives used in the data sheet prepared in this case comply with the provisions of section 328.

Law Opinion 1090 [Sec. 327. Art. 901.-31, herein.] is hereby revoked.

CARL A. MAPES,  
Solicitor of Internal Revenue.

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### Revenue Act of 1917.

The M corporation operated a so-called card-rate advertising agency. The use of capital was an essential income-producing factor in its business, and was essential in order to establish its financial responsibilities and to enable it to secure credit. It is, therefore, not entitled to assessment of 1917 taxes under section 209 of the Revenue Act of 1917.

The M corporation, which conducted an advertising agency, computed its excess-profits tax for the period ended December 31, 1917, under the provisions of section 209 of the Revenue Act of 1917. The corporation secured advertising space from publishers and was allowed a discount of — per cent or less and then it billed such space to its own clients at the full agreed price. Its principal source of income was derived from these discounts. All bills for space were made out to the corporation by the publishers and the corporation in turn rendered its bills to its clients. On receipt of the payments from its clients, the taxpayer remitted the amount to the publishers less its discount. The corporation had an average capital stock in excess of 180x dollars for the period from February 1, 1917, to January 1, 1918, and during this period it carried a large amount of accounts and notes receivable and a substantial amount of accounts payable, representing its commitments for advertising space. At the close of the year, 42x dollars

was invested in Liberty bonds. It was the custom of the corporation to advance the money necessary for mechanical work and printing, engraving, and electrotyping on behalf of its clients.

Advertising agencies with a few exceptions carry on their business as principals and not as agencies. The so-called card-rate agencies are in reality independent contractors with independent relations with publishers and advertisers. In case of default of an advertiser the loss falls upon the agency. This was admitted to be true in the case of the M Company, at an oral hearing which was accorded its representatives, but it was stated that no defaults occurred in the taxpayer's business in 1917. This responsibility has been held to contemplate the employment of capital. Indeed, it would appear that the special rates made to card-rate agencies are not available to an agency unless it can establish its financial responsibility, thus indicating that capital for credit purposes at least is absolutely essential in the conduct of the business. While it was admitted by the taxpayer that it would have to bear any loss caused by the default of a client, it has argued that no income could possibly be produced through such use of capital, since no income could result from loss, and hence that capital is not a material income-producing factor in its business. This argument does not, in the opinion of this office, affect the soundness of the rule. Obviously the use of capital in such manner is a material income-producing factor, since the agency could not hope, if it were not in a position to make good the accounts with the publishers, to continue in this line of business.

The fact that the taxpayer carried on its books a large amount of receivables representing space bills for which at some time it had been responsible to the publishers; that it carried a substantial amount of accounts payable for such space, and advanced funds in respect of art work and like expenses, indicates the necessity of the use of capital in substantial amounts in excess of that required for mere office expenses. Its investment of 42x dollars in Liberty bonds is not to be taken as having withdrawn such funds from the business, for such assets are necessary for the agency to have in order to secure credit with publishers.

It is, therefore, held that the M corporation is not entitled to assessment under section 209 of the Revenue Act of 1917.

**31**



**Section 328.—Computation of Tax in Special Cases (1918 Act—¶570, ante):**  
(1921 Act—¶1049, post).

**Article 911.—Computation of Tax in Special Cases (Reg. 45—¶832, ante): (Reg. 62—¶1244, post).**

(See 5-20-723; Section 337, Article 971.) Application of the provisions of this section in case of a corporation which is also entitled to the benefit of the provisions of section 337.

1

(See 11-20-788; Section 326, Article 845.) Adjustment of invested capital for taxable year when claim for assessment of tax for previous year under section 328 remains unsettled

2

Section 212 - (Continuation of the 1917 Act)  
 (1917 Act, 40 Stat. 1012)  
 (1917 Act, 40 Stat. 1012)  
 (1917 Act, 40 Stat. 1012)

Section 213 - (Continuation of the 1917 Act)  
 (1917 Act, 40 Stat. 1012)  
 (1917 Act, 40 Stat. 1012)

Section 214 - (Continuation of the 1917 Act)  
 (1917 Act, 40 Stat. 1012)  
 (1917 Act, 40 Stat. 1012)

Section 215 - (Continuation of the 1917 Act)  
 (1917 Act, 40 Stat. 1012)  
 (1917 Act, 40 Stat. 1012)

Section 216 - (Continuation of the 1917 Act)  
 (1917 Act, 40 Stat. 1012)  
 (1917 Act, 40 Stat. 1012)

Section 217 - (Continuation of the 1917 Act)  
 (1917 Act, 40 Stat. 1012)  
 (1917 Act, 40 Stat. 1012)

Section 218 - (Continuation of the 1917 Act)  
 (1917 Act, 40 Stat. 1012)  
 (1917 Act, 40 Stat. 1012)

Section 219 - (Continuation of the 1917 Act)  
 (1917 Act, 40 Stat. 1012)  
 (1917 Act, 40 Stat. 1012)

Section 220 - (Continuation of the 1917 Act)  
 (1917 Act, 40 Stat. 1012)  
 (1917 Act, 40 Stat. 1012)

Section 221 - (Continuation of the 1917 Act)  
 (1917 Act, 40 Stat. 1012)  
 (1917 Act, 40 Stat. 1012)

Section 222 - (Continuation of the 1917 Act)  
 (1917 Act, 40 Stat. 1012)  
 (1917 Act, 40 Stat. 1012)

Section 223 - (Continuation of the 1917 Act)  
 (1917 Act, 40 Stat. 1012)  
 (1917 Act, 40 Stat. 1012)

Section 224 - (Continuation of the 1917 Act)  
 (1917 Act, 40 Stat. 1012)  
 (1917 Act, 40 Stat. 1012)

Section 225 - (Continuation of the 1917 Act)  
 (1917 Act, 40 Stat. 1012)  
 (1917 Act, 40 Stat. 1012)

Section 226 - (Continuation of the 1917 Act)  
 (1917 Act, 40 Stat. 1012)  
 (1917 Act, 40 Stat. 1012)

Section 227 - (Continuation of the 1917 Act)  
 (1917 Act, 40 Stat. 1012)  
 (1917 Act, 40 Stat. 1012)

Section 228 - (Continuation of the 1917 Act)  
 (1917 Act, 40 Stat. 1012)  
 (1917 Act, 40 Stat. 1012)

Section 229 - (Continuation of the 1917 Act)  
 (1917 Act, 40 Stat. 1012)  
 (1917 Act, 40 Stat. 1012)



**Section 328.—Computation of Tax in Special Cases (1918 Act—¶570, ante):**  
(1921 Act—¶1049, post).

**Article 912.—Determination of First Installment of Tax in Special Cases (Reg. 45—¶833, ante):** (Reg. 62—¶1245, post).

1-19-136: O. D. 94.

Computation of tax on the basis of 50 per cent of the net income under section 328, Revenue Act of 1918, relates only to war excess profits tax. It is not permissible to file bond in lieu of cash payments of tax determined on 50 per cent basis pending final determination of tax due.

1

6-19-285: T. B. M. 30.

The application of section 210 of the Revenue Act of 1917 and sections 327 and 328 of the Revenue Act of 1918 to fiscal year returns.

A corporation having a fiscal year ending June 30, 1918, filed income and excess profits tax returns for that period under the Revenue Act of 1917. Its tax was finally assessed under section 210 of the Revenue Act of 1917. The taxpayer in making its supplemental return for the same fiscal year under the Revenue Act of 1918 wishes to use the same constructive capital as a basis for computing its excess profits tax under the Revenue Act of 1918, and appeals from a decision of the Unit advising it that this can not be done.

Section 335 of the Revenue Act of 1918, which levies the war profits and excess profits taxes for a fiscal year ending in 1918, reads in part as follows.

Sec. 335 (a). That if a corporation (other than a personal service corporation) makes return for a fiscal year beginning in 1917 and ending in 1918, the tax for the first taxable year under this title shall be the sum of: (1) The same proportion of a tax for the entire period computed under Title II of the Revenue Act of 1917 which the portion of such period falling within the calendar year 1917 is of the entire period, and (2) the same proportion of a tax for the entire period computed under this title at the rates specified in subdivision (a) of section 301 which the portion of such period falling within the calendar year 1918 is of the entire period.

In the opinion of the Advisory Tax Board the effect of this section of the statute is that the excess profits tax for a fiscal year ending in 1918 is computed in two ways. First, it is computed as if the entire income had been earned during the calendar year 1917. This involves in some cases an assessment under section 210. Second, it is computed as if the entire net income had been earned during the calendar year 1918. This involves in some cases an assessment under section 328. The proper proportions of the resulting taxes are used to determine the tax for the fiscal year.

Where possible, it would be desirable to consider the application for assessment under section 210 and the application for assessment under section 327 together. Where, as in this case, the assessment under section 210 has already been made, the taxpayer should be notified to file with its supplemental return an application for assessment under section 327. Pending decision upon its application it will be necessary for the taxpayer to compute the additional tax due upon the assumption that the excess profits tax computed under the Revenue Act of 1918 will be not more than 50 per cent of its net income, as is provided in section 328 and article 912-914, Regulations 45. In no case would the constructive capital determined under section 210 be used in making the assessment under section 328.

2

I (22)—7-97, I.T. 1210

### Revenue Act of 1918.

The installments of the tax in the case of a corporation coming within the provisions of article 912, Regulations 45, and which made its return on the basis of a fiscal year ended in 1919, should be determined as follows:

- (1) Compute the tax at 1918 rates upon the entire net income for the taxable year; that is, 50 per cent of the net income.
- (2) Compute the tax at the 1919 rates upon the entire net income for the taxable year; that is, 20 per cent of the net income in excess of \$3,000 but not in excess of \$20,000 plus 40 per cent of the net income in excess of \$20,000.
- (3) Ascertain that proportion of item 1 which the number of months within the calendar year 1918 is of the number of months in the entire period.
- (4) Ascertain that proportion of item 2 which the number of months in the calendar year 1919 is of the number of months in the entire period.
- (5) The total tax equals the sum of item 3 and item 4.

3



**Law Section 328.—Computation of Tax in Special Cases (1918 Act—¶570, ante): (1921 Act—¶1049, post).**

**Article 913.—Determination of First Installment of Tax in the Case of Foreign Corporation, or a Corporation Entitled to the Benefits of Section 262 (Reg. 45—¶834, ante): (Reg. 62—¶1246, post).**

6-20-735: O. D. 402.

The instalments of the tax for 1919 of a foreign corporation shall be determined upon the basis of an excess profits tax computed by using its invested capital for the taxable year 1917 properly adjusted by reason of subsequent changes. Because of the provisions of section 302 this tax can in no case be more than 20 per cent of the amount of the net income in excess of \$3,000 and not in excess of \$20,000, plus 40 per cent of the amount of net income in excess of \$20,000. Final determination of the tax will be made according to the provisions of sections 327 and 328.

1





**Law Section 328.**—Computation of Tax in Special Cases (1918 Act—¶570, ante): (1921 Act—¶1049, post).

**Article 914.**—Payment of Tax in Special Cases (Reg. 45—¶835, ante): (Reg. 62—¶1247, post).

26-19-599: O. D. 321.

The provisions of section 327 (d) of the Revenue Act of 1918 will not debar a corporation deriving income from Government contracts on the "per unit" basis from filing a claim for assessment under the provisions of section 328. If the claim is filed prior to the due date of the fourth installment of tax and the three installments already paid are equal to the sum of the normal tax plus a war profits and excess profits tax equal to 50 per cent of the net income of the corporation, it will not be necessary to pay the fourth installment, but the additional payments of tax, if any, with interest, may be made when the claim for readjustment of the tax is finally disposed of. The corporation should file a claim for abatement of any taxes assessed in excess of the tax computed.

1

31-19-655: O. D. 356.

In cases where application has been made at the time of filing the return for assessment of war profits and excess profits tax in accordance with section 328, Revenue Act of 1918, and the installments of tax determined and assessment made on the basis of 50 per cent of the net income for the taxable year, no abatement claim is required to cover the difference between the tax so computed and the tax computed without the benefit of section 328. If the tax has been computed and assessment made without reference to section 328, and application is made *subsequently* for assessment of the tax in accordance with section 328, payment of the entire tax as originally computed will be required unless a claim is filed for the abatement of the amount assessed in excess of 50 per cent of the net income.

2

Article 614—Payment of Tax in Special Cases (Rev. 43-7815, 4-15-43)  
 (See 43-71247, 4-15-43)  
 Law Section 518—Composition of Tax in Special Cases (1935 44-7732, 4-15-43)  
 (See 43-71247, 4-15-43)

182. 51. 0122621513

In cases where application has been made at the time of filing the return for abatement of war profits and excess profits tax in accordance with section 138, Revenue Act of 1918, and the installments of tax determined and payment made on the basis of 50 per cent of the net income for the taxable year, no abatement claim is required to cover the difference between the tax so computed and the tax computed without the benefit of section 138. If the tax has been computed and payment made without reference to section 138, and application is made subsequently for abatement of the tax in accordance with section 138, payment of the entire tax as originally computed will be required unless a claim is filed for the abatement of the amount determined to be in excess of 50 per cent of the net income.



## Law Section 330.—Reorganizations ¶(575).

## Article 931.—Scope of Reorganizations (¶837).

22-20-981: Sol. Op. 4.

WAR PROFITS AND EXCESS PROFITS TAX—REVENUE ACT OF 1918,  
INVESTED CAPITAL

A merger of two or more corporations takes place when one of such corporations retains its corporate existence and absorbs the other or others, which thereby lose their corporate existence.

A consolidation of two or more corporations is effected when a new corporation is created to take the place of the constituent corporations, which are themselves dissolved in the process.

This case involves the formation in 1904 of the M Company through a so-called merger or consolidation of three New Jersey corporations: the N Company, the O Company, and the P Company, the latter of which owned a controlling proportion of the stock of the two other constituent corporations. The question upon which advice is desired in computing the invested capital of the M Company is whether it was formed as a new corporation in 1904 in connection with the dissolution of the three constituent corporations, or whether, as claimed by the company, it was the same corporate entity (only under a different name) as the P Company which by merger had absorbed the N and O Companies.

Strictly speaking, a merger of two or more corporations takes place when one of such corporations retains its corporate existence and absorbs the other or others, which thereby lose their corporate existence. A consolidation in a strict legal sense is effected when a new corporation is created to take the place of the constituent corporations, which are themselves dissolved in the process. *Lee v. Atlantic Coast Line Railway Co.*, 150 Fed. 775, 787.

The determination of whether a union of corporations results in a merger or in the formation of a new corporation depends upon the statute under which it takes place, and the intention therein manifested. *Central Railroad Co. v. Georgia*, 92 U. S. 665, 670.

The merger or consolidation, as the case may be, which is here under consideration was effected under a New Jersey statute entitled: "An Act concerning corporations (revision of 1896)" and the several supplements thereto and Acts amendatory thereof. The statute provides that two or more corporations organized under the laws of the State for the purpose of carrying on business of the same or a similar nature may "merge or consolidate into a single corporation, which may be either one of said merging or consolidating corporations, or a new corporation to be formed by means of such merger and consolidation."

The New Jersey law clearly authorizes either a process by which one corporation retains its corporate existence and absorbs one or more other corporations, or a process by which two or more corporations unite in the formation of a new corporation; but the interpretation of the various provisions of the statute is somewhat confused for the reason that the terms "merge" and "consolidate" in their different grammatical forms are employed therein more or less indiscriminately and without regard to the true legal niceties of their respective meanings.

The Act in reality gives an option to the constituent corporations to unite either by the merger of one or more into another or by the formation of a new corporation to take the place of the old ones. Difficulty arises in determining which of the two options is exercised in a particular instance since the statute prescribes substantially the same procedure in one case as in the other. The terms of the agreement entered into as a first step in the union of the

corporations furnish the best evidence of what the parties intended in this respect.

In examining the language of the agreement entered into in 1904 between the respective directors of the N Company, the O Company, and the P Company, but little aid is obtained from a consideration of the use of the terms "merge" and "consolidate" for the reason that they are employed, as in the case of the New Jersey statute, in a confused and inexact sense. The true intention, therefore, must be ascertained by other tests.

It is claimed in behalf of the corporation that the N Company and the O Company were merged in the P Company, which retained its corporate existence under the name of the M Company. There is no evidence in the record other than the bare assertion to support that contention. If that had been the intention it is believed at least that in the resulting corporation some distinctive feature of the P Company would have been preserved by which its survivorship could be recognized. As the matter stands there is no basis other than conjecture or surmise to justify an inference that the P Company survived to any greater extent than the other two constituent companies, and it is conceded that the latter were dissolved.

It is true that the P Company by virtue of its stock holdings in the other companies was the parent corporation of the group and that its powers more nearly corresponded to the powers of the resulting M Company than to those of the other constituent corporations, but such facts merely create a likelihood that the P Company would have been the one elected to survive if any had been chosen; they do not show the fact of such election.

On the other hand, there are various provisions in the agreement which indicate that the resulting M Company was regarded as a separate corporate entity distinct from that of any of the three constituent companies, as evidenced by the following quotations:

Article V. The said corporations are merged and consolidated upon the understanding and agreement that the present indebtedness of each of said corporations shall be assumed in full by the said merged corporation.

Article VI. All property, real, personal, and mixed, of the said corporations, parties hereto, shall vest in the said merged corporation immediately upon the adoption of this agreement by the stockholders of the said corporation, as provided by the provisions of the said Act entitled "An Act Concerning Corporations (Revision in 1896)" and the several supplements thereto and Acts amendatory thereof; but if the said merged corporation shall deem or be advised that any further assignments, assurances in the law, or things are necessary or desirable to vest the title to such property in the said merged corporation, the said corporations, parties hereto, shall execute and do all such assignments, assurances in the law, and things necessary to vest title to such property in said merged corporation, and otherwise to carry out the purposes of this agreement.

Article VII (in part). The capital stock of each of the said corporations, parties hereto, shall be converted into the common stock, the preferred stock, or the obligations of said merged corporation, and the common stock, preferred stock, and obligations of said merged corporation shall be apportioned among the stockholders of the said corporations, parties hereto, according to the shares held by the respective stockholders of said corporations, and shall be delivered to them upon the surrender of their certificates of stock.

\* \* \* By the act of merger the stocks of all the companies, parties hereto, held by any of the companies, parties hereto, shall stand and be canceled.

The most important evidence as to the status of the M Company is found in article II of the agreement of 1904. As a first step in the union of corporations the New Jersey statute provides for an agreement between the directors, which must then be submitted to and ratified by a two-thirds vote of the stockholders of the respective corporations. Thereafter the perfected agreement is to be filed with the Secretary of State when the merger or consolidation becomes complete, and the resulting corporation becomes vested with all the powers, rights, privileges, and franchises of the constituent corporations. The statute also prescribes what must be embodied in the agreement, including the terms and conditions of the merger or con-



solidation, the mode of carrying the same into effect, and various other provisions, but does not require any statement therein of the powers of the resulting corporation. In article II of the directors' agreement in the case at hand it is expressly provided that the said merged corporation in addition to the powers conferred by section 1 of the "Act Concerning Corporations" (which section covers the usual powers of corporations) "shall have the powers herein set out." Then follows an elaborate enumeration.

It appears, therefore, that it was the intention of the agreement to vest the so-called "merged corporation" with a distinct and complete set of powers such as would be conferred upon a new corporation rather than to permit the statute itself to operate by conferring on it merely the resultant powers of the old corporations.

Thus the final result of the union of the N Company, the O Company, and the P Company was that each of said corporations alike was left without property and stock—the latter of which particularly, or its equivalent, is in some form essential to corporate existence, *Keokuk & Western Railroad v. Missouri*, 152 U. S., 301; 309—and there emerged in their place a corporation having new stock, new officers and directors, and a new, distinct, and complete grant of corporate powers.

In view of the foregoing considerations, particularly of the distinct corporate character designed for the resulting corporation as evidenced by the directors' agreement, and also the lack of evidence to manifest the intention of the parties that the P Company, or any of the other constituent corporations, should survive and absorb the others, it is my opinion that the M Company was created as a new corporation in 1904 through the union of the N Company, the O Company, and the P Company.

WAYNE JOHNSON,  
*Solicitor of Internal Revenue.*

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(See 25-20-1022; Section 331, Article 941.) Valuation of assets transferred upon change of corporate entity.

2

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16-21-1586: A. R. R. 467

#### REVENUE ACT OF 1917.

Held, that a corporation, organized in October, 1917, which acquires the business and properties of a partnership as of January 1, 1917, the ownership continuing identical as does the business, can not make a return for the entire year, as if it were a corporation, using the invested capital of the partnership as of January 1, 1917, as its invested capital.

The Committee has had under consideration the appeal of the M Company from the action of the Income Tax Unit in denying this corporation, which was organized in October, 1917, the right of filing a corporate return for the full taxable year 1917, by treating the partnership prior to October, 1917, as if it were a corporation.

The M Company was incorporated October, 1917, taking over the partnership business of two brothers. By a written agreement, between the corporation and the partnership, the corporation acquired all of the assets of the partnership, including the business, as of January 1, 1917, and assumed its obligations from that date. Except for one or two statutory shares the two partners received the entire capital stock of the corporation. All necessary

adjustments were made to state the balance sheet as of January 1, 1917, and certain transactions of the partners were revoked in order that the identical book values and liabilities as of January 1, 1917, might be assumed by the corporation under the agreement with the partners.

It is stated that the corporation, between October, 1917, and January 1, 1918, paid dividends to its stockholders, offered to pay its capital stock tax for said year of 1917, and at the proper time in 1918 filed its corporate return with the Federal Government covering the entire year 1917, using as its invested capital the invested capital of its predecessor as of January 1, 1917.

The corporation, in making an appeal to this Committee to sustain its action in filing a corporation return for the full taxable year 1917, relies upon section 204 and section 208 of the Revenue Act of 1917, and upon section 330 of the Revenue Act of 1918. Section 204 of the Revenue Act of 1917 established a basis for prewar data, while section 208 has to do with invested capital *at date of reorganization, consolidation or change in ownership*. It does not apply retroactively to the beginning of the taxable year but is applicable only to the value of assets immediately transferred.

Section 330 (articles 931, 932, 933 of Regulations 45) approves the practice followed by the taxpayer for the year 1917, except for the important provision that the net income of a trade or business *from January 1, 1918*, to date of reorganization, if reorganized on or before July 1, 1919, may be taxed as that of a corporation.

There was no provision in the 1917 law for treating a partnership in the taxable year as if it were a corporation, and Congress did not see fit to make section 330 of the 1918 Act retroactive to include the taxable year 1917 at the rates of taxation then in effect.

The Committee does not consider that it can read into the 1917 law, under any of the sections therein, an authority to disregard, for taxation or otherwise, the important distinctions between a partnership and a corporation.

It is accordingly recommended that the action of the Income Tax Unit in denying this corporation the privilege of using the invested capital of the partnership as of January 1, 1917, and of considering the income of the partnership during the taxable year 1917 as if it were the income of the corporation, be sustained under section 208 of the Revenue Act of 1917.

3

21-21-1657: O. D.930.

Where under the laws of a State a charter granted to a corporation is limited to a period of years, the renewal of such charter merely prolongs the existence of the original corporation and does not of itself constitute a reorganization within the meaning of the excess profits tax laws.

4



**Law Section 330.—Reorganizations (§575).**

**Article 932.—Net Income and Invested Capital of Predecessor Partnership or Individual (§838).**

1-19-137: T. B. R. No. 2.

The provisions of section 208 of the Revenue Act of 1917 should be applied on the basis of the adjusted balance sheet of the predecessor as of the date of reorganization.

This section reads:

That in case of the reorganization, consolidation, or change of ownership of a trade or business after March 3, 1917, if an interest or control in such trade or business of 50 per centum or more remains in control of the same persons, corporations, associations, partnerships, or any of them, then in ascertaining the invested capital of the trade or business no asset transferred or received from the prior trade or business shall be allowed a greater value than would have been allowed under this title in computing the invested capital of such prior trade or business if such asset had not been so transferred or received.

The question at issue is whether the provision quoted above required the new corporation to base its invested capital on (1) the invested capital of the predecessor as of the beginning of the then taxable year of the predecessor, or (2) on the basis of the balance sheet of the predecessor as of the date of reorganization.

This provision should be held to require the new corporation to base its invested capital on the adjusted balance sheet of its predecessor as of the date of reorganization. The limitation in this section relates in terms to the value which shall be placed upon assets transferred or received from the prior trade or business. Appreciation in the value of assets so transferred or received can not be included in the invested capital of the new corporation. The statute, however, does not prohibit the treatment of the date of reorganization as the beginning of a new taxable year. Consequently it does not require the exclusion from the invested capital of the new corporation of surplus and undivided profits earned between the beginning of the then taxable year of the predecessor corporation and the beginning of the taxable year of the new corporation.





**Law Section 330.—Reorganizations (§575).****Article 933.—Election to be Taxed as Corporation (§839).**

1-19-138: O. D. 95.

Partnership net income as contemplated in section 330, paragraph 3, Revenue Act of 1918, means the net income after deducting salaries of partners.

1

6-19-286: T. B. R. 27.

Recommendation in the case of the application of the X Company for permission to incorporate and then make an affiliated return with three corporations owned by the same individuals.

The X Company is a partnership owned by two individuals with equal interests. In 1918 the partnership owned all or more than 99 per cent of the capital stock of three corporations, Y Company, Z Company, and the W Company. The request now before the Bureau is that the partnership should be allowed to incorporate before July 1, 1919, in accordance with section 330, Revenue Act of 1918, and thereafter be allowed to file a consolidated return with the other three corporations which the partnership now owns.

Section 330 of the 1918 Revenue Act provides that:

In the case of the organization as a corporation before July 1, 1919, of any trade or business in which capital is a material income-producing factor and which was previously owned by a partnership or individual, the net income of such trade or business from January 1, 1918, to the date of such reorganization may at the option of the individual or partnership be taxed as the net income of a corporation is taxed under Titles II and III; in which event the net income and invested capital of such trade or business shall be computed as if such corporation had been in existence on and after January 1, 1918, \* \* \*. *Provided*, That this paragraph shall not apply to any trade or business the net income of which for the taxable year 1918 was less than 20 per centum of its invested capital for such year: \* \* \*.

In the case of the X Company it has been stated that the income of this partnership was more than 20 per cent of its invested capital for the year 1918. Such being the fact, it appears that the law specifically gives to this partnership the right to make return as a corporation for the year 1918 if it shall, before July 1, 1919, organize as a corporation.

While the partnership has a net income of more than 20 per cent of its invested capital, the affiliated group of corporations will have a net income of less than 20 per cent of their invested capital, but this fact does not deprive the partnership of the privilege of incorporating and paying the tax as a corporation for the year 1918.

The partnership upon becoming a corporation in accordance with the provisions of the law, and owning 99 per cent of the capital stock of the other three corporations referred to above, should, in the opinion of the Advisory Tax Board, file a consolidated return.

2

11-19-373: O. D. 211.

If a partnership was an "original subscriber" to Liberty bonds of the fourth series and was reorganized as a corporation prior to July 1, 1919, and elects to be taxed as a corporation from January 1, 1918, in accordance with section 330, Revenue Act of 1918, the corporation will be considered

an "original subscriber" to Liberty bonds of the fourth series within the meaning of article 79 of Regulations No. 45.

3

11-19-393: O. D. 223.

A partnership whose net income for the taxable year 1918 was more than 20 per cent of its invested capital may elect to be taxed as a corporation from January 1, 1918, only in case of its reorganization as a corporation before July 1, 1919. There is no authority vested in the Treasury Department to extend the time within which to effect the reorganization.

4

15-20-854: O. D. 457.

Returns for 1918 were filed for a partnership and its members in accordance with the Revenue Act of 1917, prior to the passage of the Revenue Act of 1918, and tax paid accordingly. The partnership was incorporated prior to July 1, 1919, and elected to be taxed as a corporation under the provisions of paragraph 3, section 330, Revenue Act of 1918. Amended returns for 1918 showing overpayment of tax were filed by the partners.

There is no provision in the law whereby either the tax paid by the partnership or any excess tax paid by the partners may be credited against any tax liability of the successor corporation for any year. Remedy may be sought only by the partnership and the individual members thereof filing claims for the refunding of any excess tax paid.

6

16-20-872: O. 1023.

#### *Corporations De Facto.*

No taxpayer can be entitled to the benefits of the third paragraph of section 330 unless a corporation *de jure* or *de facto* came into existence prior to July 1, 1919.

The intention to incorporate, the execution and mailing of the articles of incorporation to the Secretary of State on June 30, 1919, the opening of corporate books as of June 30, 1919, and the manufacturing for one day under the same name as used by the partnership, in the absence of other proof of user prior to July 1, 1919, held not to justify the inference that a corporation *de facto* existed before July 1, 1919.

The M Company was a partnership engaged in manufacturing during the calendar year, 1918. Early in 1919 the advisability of incorporating and obtaining the benefits of section 330 of the Revenue Act of 1918 was considered and a determination to incorporate prior to July 1 was reached. So far as appears only the following events took place prior to July 1: The determination to incorporate was reached. The plant closed down on June 27, and an inventory was taken as of June 27. No business was transacted as a partnership after June 27. The plant reopened on June 30; and the accounts of the corporation began as of June 30. So far as appears the only work done on June 30 was manufacturing. Articles of incorporation were drafted, signed, and acknowledged, and mailed to the Secretary of State on June 30. Minutes of the first meeting and by-laws were drafted by counsel, and it was decided who the temporary dummy directors should be.

No other evidence tending to show user of corporate powers prior to July 1 was in evidence, although the parties made every effort to produce all facts in their favor.

Because of defects in the articles, they were returned by the Secretary of State, amended, and actually filed on July 2, 1919. It was stated orally that the first meeting was held, directors were elected, and the property was formally transferred from the partnership to the corporation after July 2.



It is the contention of the company that it became a *de facto* corporation on June 30, 1919. Section 330, of the Revenue Act of 1918, reads in part as follows:

In the case of the organization as a corporation before July 1, 1919, of any trade or business in which capital is a material income-producing factor and which was previously owned by a partnership or individual, the net income of such trade or business from January 1, 1918, to the date of such reorganization may at the option of the individual or partnership be taxed as the net income of a corporation is taxed under Titles II and III; in which event the net income and invested capital of such trade or business shall be computed as if such corporation has been in existence on and after January 1, 1918, and the undistributed profits or earnings of such trade or business shall not be subject to the surtax imposed in section 211, but amounts distributed on or after January 1, 1918, from the earnings of such trade or business shall be taxed to the recipients as dividends, and all the provisions of Titles II and III relating to corporations shall so far as practicable apply to such trade or business: *Provided*, That this paragraph shall not apply to any trade or business the net income of which for the taxable year 1918 was less than 20 per centum of its invested capital for such year: *Provided further*, That any taxpayer who takes advantage of this paragraph shall pay the tax imposed by section 1000 of this Act and by the first subdivision of section 407 of the Revenue Act of 1916, as if such taxpayer had been a corporation on and after January 1, 1918, with a capital stock having no par value.

This is a remedial provision and should be liberally construed. It will be assumed that in this controversy the Government stands in the same position as an ordinary creditor, and that it is sufficient if the existence of a *de facto* corporation is shown.

The requisites of a *de facto* corporation are, first, the existence of a charter or law under which a corporation with the powers assumed might lawfully exist; second, an effort in good faith to incorporate thereunder; and, third, an actual user or exercise of corporate powers. *Tulare Irrigating District v. Sheppard*, 185 U. S. 1.

In applying these tests, however, there is considerable conflict in the decisions even from the same jurisdiction. It may be admitted that the first two requisites were complied with in this case on June 30; but there is great doubt whether there was a sufficient user or exercise of corporate powers prior to July 1, 1919, to justify a decision that a *de facto* corporation existed. Only one day's user of corporate powers is claimed, and so far as appears no business of a peculiarly corporate nature was transacted on that day.

It is essential to the existence of such a corporation (a *de facto* corporation) that there be user of such corporate rights as could be authorized by law and not merely such as might be exercised by individuals or unincorporated societies. If such a user, therefore, consists only of acts or proceedings that might be exercised without incorporation, a corporation *de facto* will not usually be inferred therefrom. (Citing cases.) Under the allegations of the bill the name "Elgin Jewelry Company" was so used by defendants under which to conduct their business before any attempt at incorporation, and the use of such name is entirely consistent with individual or copartnership capacity.—*Elgin National Watch Company v. Loveland*, 132 Fed. 41, 45, 1904.

Merely manufacturing under the name of M Company is, therefore, not a sufficient user of corporate powers, since they were merely doing what had been done for a long period under the same name by the copartnership. In fact it affirmatively appears that the acts, which are usually the first acts, such as first meeting, adoption of by-laws, and election of officers, took place after July 1.

A recent authority, discussing the question of user in this connection, says:

Generally, it is sufficient to show that the corporation was acting as a corporation and transacted business as such. But there is no fixed rule for determining just how much business must be done. Taking subscriptions to and issuing stock, electing managers and directors, adopting by-laws, buying a lot and constructing and leasing a building upon it; electing officers and trustees, who manage the corporate property for years, and lease and mortgage it, and expend large sums of money, executing powers of attorney, and loaning money and taking a loan and mortgage therefor, have been held to be sufficient. (Fletcher, *Cyclopedia of Corporations*, Vol. I, p. 625.)

It is significant that the illustrations given all include action of a peculiarly corporate nature and all include acts which are not present in the case under consideration.

It is clear that mere execution of the articles of incorporation is not a sufficient basis for inferring the existence of a corporation *de facto*. *Stevens v. Episcopal Church History Co.*, 125 N. Y. Supp. 573. The mailing of such articles to the Secretary of State may indicate an attempt in good faith to comply with the statutory requirements but can not be said to be a user of corporate powers. (Fletcher, *Cyclopedia of Corporations*, Vol. I, p. 625.)

In the case of *Childs v. Smith*, 45 N. Y. 34, principally relied upon by the taxpayer, meetings were held, officers were elected, by-laws adopted, minutes kept, and business done. These were peculiarly corporate acts and indicated a state of facts very different from the one now in question. (So in *re Cordova Shop*, 216 Fed. 818.)

No case has been found which would justify a decision that there was a sufficient user of corporate powers prior to July 1, 1919, in this case from which to infer the existence of a corporation *de facto*. Under these circumstances administrative officers are not justified in extending the definition of *de facto* corporation beyond the limits established by the courts. Nor can the administrative officers extend the time limit established by Congress in section 330.

Some reliance is placed by the taxpayer upon the language of section 330 which requires the "organization as a corporation before July 1, 1919, of any trade or business." Under any interpretation of these words, however, it seems clear that a corporation *de jure* or *de facto* must exist prior to July 1. No such corporation existed at that time in this case, and the taxpayer must therefore be denied the benefits of section 330.

13-21-1529; O. D. 855

The M Company operated as a partnership until June 30, 1919, on which date it was incorporated.

The accounting period of the partnership, as well as that of the corporation, was a calendar year. During the calendar year 1918 the partnership earned a net income, and during the period from January 1 to June 29, 1919, it suffered a net operating loss. The corporation also suffered a net operating loss during the period from June 30 to December 31, 1919. Held, that since neither the net operating loss sustained by the partnership nor the net operating loss suffered by the corporation was a loss for a full taxable year, neither organization is entitled to deduct the amount of its net loss from the net income for either the preceding or succeeding taxable year as provided by section 204 (b) of the Revenue Act of 1918.

If, however, the organization is qualified and elects to take advantage of the provisions of section 330 of the Revenue Act of 1918 and article 933 of Regulations 45, it is then entitled to seek relief under section 204 by applying the total net operating loss sustained during the entire year 1919 against the net income of the year 1918 and applying the excess, if any, of the 1919 loss over 1918 net income against the net income of the year 1920.



II(23)-35-1223: I. T. 1857.

**Revenue Act of 1918.**

Section 330 is interpreted as meaning that members of partnerships existing January 1, 1918, and members of partnerships formed subsequent to that date were equally entitled to its benefits, provided they came within its other provisions.

The O partnership was formed April 1, 1918. On October 31, 1918, the partnership was reorganized as a corporation, and the business passed into the ownership and control of the M Company, which was formed for the purpose of succeeding to the title and interest of the individual partners. A corporation return was filed for the period from April 1, 1918, to December 31, 1918. It is now argued, in substance, by the taxpayer that the provisions of section 330, to the effect that the net income of a trade or business previously owned by an individual or partnership, and otherwise within the scope of that section—

\* \* \* from January 1, 1918, to the date of such reorganization may at the option of the individual or partnership be taxed as the net income of a corporation is taxed under Titles II and III; in which event the net income and invested capital of such trade or business shall be computed as if such corporation had been in existence on and after January 1, 1918, and the undistributed profits or earnings of such trade or business shall not be subject to the surtax imposed in section 211, but amounts distributed on or after January 1, 1918, from the earnings of such trade or business shall be taxed to the recipients as dividends, and all the provisions of Titles II and III relating to corporations shall so far as practicable apply to such trade or business: *Provided*, That this paragraph shall not apply to any trade or business the net income of which for the taxable year 1918 was less than 20 per centum of its invested capital for such year: \* \* \*

confines the benefit of that section to such partnerships as were in existence at January 1, 1918, and that a partnership coming into existence during 1918 at a date subsequent to January 1 must make a return as a partnership during the time the business was conducted as a partnership venture, and that a separate corporation income and profits tax return must be made for the period in 1918 subsequent to the organization of the business as a corporation. It is desired to file amended returns on this basis.

This office does not agree with this contention. The Revenue Act of 1918 was passed February 24, 1919, and was retroactive and was effective as of January 1, 1918. Under its provisions the rates of the surtax imposed upon individuals were greatly increased, and as individual partners were taxed upon their shares in the undistributed net income of partnerships accumulated during 1918, a situation was created which might have caused hardship and even financial embarrassment to the individual members of a partnership who had been unable to anticipate this radical increase over the 1917 surtax rates and whose business methods had been pursued in accordance with their best interests as dictated by the provisions of the 1917 law. As an act of justice to persons so situated, section 330 was introduced into the 1918 Act. This section enabled such persons to protect themselves against increased individual taxation through the exercise of an option to have the income of their business for the entire taxable period in 1918 taxed as the income of a corporation in the manner indicated by the provisions of that section, and provision was made so that this right to protection might be exercised to and including June 30, 1919.

No good reason is found for restricting the provision of section 330 to members of partnerships which were in existence at January 1, 1918, nor does the language employed in section 330 require such a construction. The date January 1 is used in this section to designate the date beyond which the benefits of an election could not be enjoyed, as beyond that date the provisions of the Revenue Act of 1917 still remained effective. There is no

reason why the members of a partnership formed at January 2, 1918, were not as much entitled to protection and relief as the members of a partnership existing at January 1 of that year, and the same reason that applies to January 2 applies to all subsequent dates within the scope of section 330. The hardship to be relieved and the danger to be averted were as much present in the one case as in the other. As a greater period of time includes a less, this office construes the language of section 330 to mean that members of partnerships existing at January 1, 1918, and members of partnerships formed subsequent to that date, were equally entitled to the benefits of section 330, provided they came within its other requirements.

8



**Law Section 331.—Valuation of Assets Upon Reorganization (1918 Act — §579, ante): (1921 Act—§1053, post).**

**Article 941.—Valuation of Asset upon Change of Ownership (Reg. 45— §841, ante): (Reg. 62—§1248, post).**

(See 10-19-365; Section 326, Article 831.) Valuation of assets where merger takes place prior to March 3, 1917, but formal transfer of tangible assets is subsequent to that date.

1

(See 11-19-389; Section 326, Article 831.) Determination of invested capital when property purchased at receiver's sale is purchased by creditors and transferred to new corporation.

2

3-20-697: A. R. R. 16.

Mere change of domicile without change as to capital and surplus held not to affect the invested capital, which remains the same for the new company as for the old.

The facts in the case appear to be that the M Company, a corporation organized in a certain State, decided that its development would be hampered by its organization in that State and it was therefore decided to reincorporate the company in another State. Accordingly, a new corporation was formed in another State which exchanged its stock directly with the stockholders of the old corporation for their stock, share for share. No change was made in the capitalization or the surplus, but after it had acquired all of the stock of the old corporation the assets of the old corporation were transferred to the new corporation and the charter of the old corporation surrendered. This was in essence merely a reincorporation in a different State without essential change as to business, capitalization, or surplus.

The change of domicile took place in 1916, and the Committee has considered a number of precedents established under the Acts of 1913 and 1916 with regard to the treatment of essentially similar transactions. It finds that under such conditions it was the practice of the Bureau to require only one return as covering the income of both the old and the new corporation. It also finds that in numerous cases it was held that no income accrued to the stockholders by reason of exchange of their stock in the old for stock in the new corporation.

The Committee is of the opinion that it is not necessary to make any radical departure from the "distinct entity" theory which has been the guide of the Bureau in the past, but feels that where there is merely a transfer of domicile through the surrender of the charter issued in one State and the taking out of a new charter in another State, without any change in the business or amount of the capital and surplus of the corporation, that the new company is entitled to the same invested capital as the old.

It is therefore recommended that the M Company (new) be permitted to use the invested capital which would have been permitted the M Company (old) if there had been no surrender of charter, and change of domicile.

3

15-20-855: O. D. 458.

The provisions of section 331 of the Revenue Act of 1918 relate only to the computation of invested capital. In the reorganization of a corporation owning timber lands and engaging in the manufacture of lumber, the basis for deductions for depletion of the timber and depreciation of the plant, machinery and patents claimed by the reorganized company is the cost of these assets at the time they were acquired in reorganization, or their fair market value as of March 1, 1913, if acquired prior thereto.

4

25-20-1022: A. R. M. 60.

### REVENUE ACT OF 1917

The question is submitted whether or not where there was a change of corporate entity prior to March 3, 1917, without a change of officers or directors, or proportions of stockholdings, the new corporation is limited in its invested capital to that which might be claimed by the old corporation, or whether, in such case, the new corporation is entitled to recognize the cash value of assets for which its stock was issued not in excess of the par value thereof.

The point is illustrated by the cases of two corporations, each of which was reorganized in 1916 and the larger amount of stock issued against appreciated value, patents, good will, etc.

Section 207 of the Revenue Act of 1917 provides for the recognition as invested capital of—

(1) Actual cash paid in; (2) the actual cash value of tangible property paid in other than cash, for stock or shares in such corporation or partnership, at the time of such payment . . . , etc.

It is clear that this means subject only to the limitation in the section itself and in section 208, the actual cash paid in or the actual value of tangible assets paid in to the specific corporation, which is the present taxpayer. The limitation in section 208 referred to is:

That in case of the reorganization, consolidation, or change of ownership of a trade or business after March third, nineteen hundred and seventeen, if an interest or control in such trade or business of fifty per centum or more remains in control of the same persons, corporations, associations, partnerships, or any of them, then in ascertaining the invested capital of the trade or business no asset transferred or received from the prior trade or business shall be allowed a greater value than would have been allowed under this title in computing the invested capital of such prior trade or business if such asset had not been so transferred or received, unless such asset was paid for specifically as such, in cash or tangible property, and then not to exceed the actual cash or actual cash value of the tangible property paid therefor at the time of such payment.

The necessary corollary of the provision quoted above is that if the reorganization, consolidation, or change of ownership took place prior to March 3, 1917, the actual value of the assets paid in, limited by the provisions of section 207, is the invested capital.

The only question, therefore, left in the case is: Was there such a change of entity in the corporations named as to create in effect a new corporation? The uniform practice for some years in dealing with the question of sales of stock has been to treat every change of corporate entity as the creation of a new organization. The only exception to this has been in the case of a mere change of domicile; that is to say, surrender of charter in one State and the taking out of a new charter in a different State, without change, however, in the amount of the stock, the identity of the stockholders or capital and surplus as it appears on the books of the corporation.



It is clear that under the rulings of the office stockholders who, in either of the cases above mentioned, surrendered their stock, receiving therefor stock in the new corporation, would have been held liable to income tax if the value of the stock received was in excess of the cost of the stock surrendered therefor, or the value of such surrendered stock on March 1, 1913, on the ground that there had been an exchange of property of one kind for property of a different kind.

The Committee is therefore clearly of the opinion that both of the corporations in question are entitled to the actual cash value of the tangible and intangible properties paid in for their stock in 1916, subject only to the limitations provided in section 207 as to the value of the intangibles which may be recognized.

5

34-20-1159: Sol. Op. 41.

**EXCESS PROFITS TAX: REVENUE ACT OF OCTOBER 3, 1917.  
CORPORATION INCOME TAX: REVENUE ACT OF 1918.**

Where a corporation transfers its property to an association composed of its stockholders, and the association after January 1, 1914, but prior to March 3, 1917, transfers substantially the same assets to a new corporation, the fair market value of such assets when transferred to the new corporation should be included in determining the invested capital of the latter.

Proceeds of a judgment recovered in 1918 are income for the year in which received, not for the year or years in which the right of action accrued.

The appeal of the M Company of Texas raises the following questions:

1. Should the property received by the company in or about June, 1914, in return for its entire issue of capital stock, be valued for the purpose of determining invested capital as of the date of transfer, or as of an earlier time, since it appears that the property transferred has been acquired several years previously by a preceding corporation, and by it assigned to an association composed of its stockholders?

2. For what year or years should income derived from the sale of oil be returned where delivery of the oil was made in 1914 and 1915, but only one-half of the purchase price was paid at that time, and the balance was received in 1918, as the result of the entry of a final judgment in a court proceeding?

The war excess profits tax law of October 3, 1917, provides:

Sec. 207. \* \* \*

As used in this title "invested capital" \* \* \* means subject to the above limitations:

(a) In the case of a corporation or partnership: (1) Actual cash paid in, (2) the actual cash value of tangible property paid in other than cash, for stock or shares in such corporation or partnership, at the time of such payment \* \* \*.

Sec. 204. \* \* \*

A trade or business carried on by a corporation, partnership, or individual, although formally organized or reorganized on or after January second, nineteen hundred and thirteen, which is substantially a continuation of a trade or business carried on prior to that date, shall, for the purposes of this title, be deemed to have been in existence prior to that date, and the net income and invested capital of its predecessor prior to that date shall be deemed to have been its net income and invested capital.

Prior to March, 1914, the M Company was a corporation organized and existing under the laws of the State of Louisiana and owned property located there.

In March, 1914, this corporation, pursuant to a resolution of its stockholders, duly transferred, sold, and conveyed all of its property to certain stockholders as trustees for themselves and the other stockholders of the company. It was provided in the resolution authorizing such transfer that

the trustees named should have authority to conduct the business theretofore carried on by the corporation in the form of a limited partnership under the name of the M Company, (Ltd.), and that the trustees should also liquidate the corporation affairs of the M Company of Louisiana.

In June, 1914, the M Company of Texas was duly incorporated under the laws of the State of Texas, having been organized by the above named trustees. The entire issue of capital stock of the new corporation was thereupon issued to the trustees and beneficiaries of the M Company (Ltd.), the above named limited partnership, in return for all of the assets of that partnership owned jointly by the principals thereof, who were the sole and only stockholders of the original M Company of Louisiana.

It is represented that the assets of the limited partnership were in value greatly in excess of the par value of the stock issued by the M Company of Texas, as purchase price thereof, and that company contends that the excess in value of said property when transferred to it in return for its capital stock over the par value of that stock shall be regarded as paid in surplus under the Revenue Act of 1918.

As to the year for which proceeds of the judgment obtained by the M Company against the X Company should be returned as income, the facts were as follows: A contract was made in 1912, between the X Company and the M Company, by which the latter agreed to sell to the former—and the former to buy—oil produced from certain wells of the M Company. The contract was to become effective December 25, 1912, and to continue in force for two years. The X Company agreed to pay for the oil delivered at the rate of 90 cents per barrel, and was given an option of purchasing any oil delivered in excess of the agreed maximum at the market price prevailing at the time of delivery. The X Company was also given an option to extend the contract for a period of two years after its expiration, December 24, 1914, to pay for the oil thereafter delivered at a price equal to the highest contract price then being paid by any one of four of the largest purchasing companies. Before the expiration of the contract in 1914, the X Company exercised its option to extend the same for a period of five years, and notified the M Company that the price for oil sold thereunder would be 60 cents per barrel, as that was the price for which the companies were at that time making contracts.

In acknowledging receipt of the letter exercising the option the M Company advised that the price of oil would be \$1.00 per barrel, as that was the highest price then being paid by purchasing companies under contracts already existing. The parties being unable to come to an agreement as to price made an arrangement by which the M Company delivered the oil as provided in the contract, but the X Company paid only 50 cents per barrel, leaving the balance of the purchase price to be paid as determined by the courts. Suit was brought by the M Company, as a result of which judgment was finally obtained in 1918, ordering the X Company to pay the balance of 50 cents per barrel.

First, as to the time the capital assets in question should be valued for the purpose of determining invested capital. The excess profits tax law of 1917, explicitly provides that the term "invested capital" includes the actual cash value of tangible property paid in other than cash for stock or shares in the corporation. (Section 207.) This is the general provision and applies to the term "invested capital" whenever used in the title. One qualification is found in cases in which it is sought to determine invested capital for the prewar years, viz: 1911, 1912, and 1913. This qualification is found in section 204, which provides, in substance, that if the trade or business carried on by the corporation existed prior to January 2, 1913, although the reorgani-



zation took place later, the invested capital of the new organization shall be deemed to be no greater than that of its predecessor. This provision, however, applies only to determination of invested capital for prewar years, and has been so regarded by the Bureau. (See Regulations 41, article 22.)

A further qualification of the general rule is found in section 208 which provides, in substance, that in the case of the reorganization, consolidation or change of ownership of a trade or business after March 3, 1917, if an interest or control in such trade or business of fifty per centum remains in control of the same persons, or any of them, the invested capital of the trade or business shall be ascertained by allowing no greater value to any of the assets transferred to the new corporation than would have been allowed in computing invested capital of such prior trade or business if such asset had not been transferred, unless such asset was paid for specifically in cash or tangible property.

The fair inference to be drawn from section 208 is that in the case of such reorganization before March 3, 1917, the general rule shall apply, viz: **Assets should be valued as of the date of transfer** to the new corporation for the purpose of determining the invested capital of such corporation.

As to the second question, viz: Whether income derived from the sale of oil to the X Company should be reported for the years 1914 and 1916, when the oil was delivered and part of the purchase price paid, or for the year 1918, when final judgment was secured and balance of the purchase price paid.

In *Jackson v. Smietanka*, T. D. 2960, which was decided very recently in the District Court for the Northern District of Illinois, Eastern Division, it was held that a fee of \$100,000, determined and received in 1918, for services rendered and received during five years, was income for the year of payment, although the receiver had a court order allocating to each of the years a portion of the entire amount.

In the instant case the M Company delivered oil during the years 1914 and 1915, under a contract so worded as to give rise to a dispute as to the amount of purchase price. The X Company was willing to pay 60 cents per barrel. The M Company demanded \$1.00 per barrel. The parties agreed to pay and receive 50 cents per barrel, and to leave the balance of the price to be determined by the court. The 50 cents per barrel paid by the X Company in 1914 and 1915 was, so far as the record shows, included in the gross income of the M Company for those years. The record does not show that the M Company accrued on its books the balance of 50 cents per barrel. Sound business policy would not have permitted such accrual, for at that time there was no assurance that the amount of 50 cents per barrel would be recovered. Since the X Company had agreed to pay 60 cents per barrel, it would seem that 10 cents per barrel could have been set up on the books of the M Company in 1914 and 1915 as accrued. As to any further amount, however, there was a grave element of doubt. In fact, in the lower court it was held that the contract price was 50 cents per barrel, and it was not until the final determination in 1918, that the price was fixed at \$1.00 per barrel. For this reason it is believed that the facts in this case bring it squarely within the principle laid down by the court in *Jackson v. Smietanka* above. There, as here, the services had been performed in prior years, but it was not possible for the parties, as in this case, during such prior years, to fix and determine an amount as representing the final amount to be received. The opinion is accordingly expressed that the entire proceeds of the judgment recovered by the M Company in 1918, should be reported as gross income for the year of actual receipt.

It is accordingly held that where a corporation transfers its property to an association composed of its stockholders, and the association after January

1, 1914, but prior to March 3, 1917, transfers substantially the same assets to a new corporation, the fair market value of such assets when transferred to the new corporation should be included in determining the invested capital of the latter; that the proceeds of a judgment recovered in 1918, are income for the year in which received, not for the year or years in which the right of action accrued.

WAYNE JOHNSON,  
*Solicitor of Internal Revenue.*

6

42-20-1252: A. R. R. 285.

The Committee has had under consideration the appeal of the M Company, from the action of the Income Tax Unit eliminating an item of 40x dollars from the invested capital claimed for the years 1917 and 1918.

It appears that the N Company, a Massachusetts corporation, was organized in 1907; that in 1917 the M Company was organized under the laws of the State of Connecticut, with an authorized capital stock of 150x dollars, of which 80x dollars was issued for the purpose of taking over all the assets and liabilities of the N Company, a Massachusetts corporation. The charter of the reorganized corporation was drafted so that the corporation could engage in the collateral business of owning and renting real estate in addition to its regular business.

In 1917, subsequent to March 3, the newly organized corporation took over the entire assets and assumed the liabilities of the Massachusetts corporation. Some time after that date the Massachusetts corporation surrendered its charter and was dissolved.

A complete field audit of the returns filed by the M Company for the years 1917 and 1918, has been made and the report has been received, audited, and accepted by the Income Tax Unit. Minor adjustments were made in the net income for these years, all of which have apparently been accepted by the corporation. The additional tax found is due largely to the adjustment of the invested capital for these years.

The revenue agent in his report deals quite fully with the reorganization of the corporation and the transfer to it of certain parcels of improved real estate by A, the principal stockholder of both corporations. It appears that soon after the transfer of the assets of the Massachusetts corporation to the M Company, the newly organized corporation, A, its principal stockholder, transferred certain real estate to the new corporation for stock. Such transfer was made after March 3, 1917, and the revenue agent has included in invested capital for both years the adjusted cost of such real estate to A.

The adjustment made was proper for 1918, and was in accordance with the provisions of section 331 of the Revenue Act of 1918, and article 941 of Regulations 45. The same adjustment for 1917 was not proper, if the corporation can show that at the time of acquisition of the real estate in question such real estate had a cash value in excess of the adjusted cost allowed by the revenue agent.

It will be noted that in section 208 of the Revenue Act of 1917 the phrase "or change of ownership of property after March 3, 1917," does not appear, but section 208 deals with reorganizations, consolidations, or change of ownership of a trade or business after March 3, 1917, where 50 per cent of the control remains with the same person or persons. Section 331 of the Revenue Act of 1918 goes a little further and takes in any change of



ownership of property after March 3, 1917, where an interest or control in such trade or business or property of 50 per cent or more remains in the same person or persons. In accordance with the above and under the provisions of section 208 of the Revenue Act of 1917, if the corporation can show that the real estate acquired from A after March 3, 1917, even though 50 per cent or more of the ownership remains in A, had a value in excess of the cost as adjusted by the revenue agent, the corporation is entitled to include the actual cash value of the property at the date of acquisition. This is not true, however, with respect to the 1918 return. The limitation is extended by the provisions of section 331 to any change of ownership of property after March 3, 1917, where an interest or control of 50 per cent or more remains in the same person or persons. The amount which can be included in the computation of invested capital is limited to the actual cost, plus improvements, less depreciation, of the physical property so transferred. Therefore the adjustment made by the revenue agent for 1918 appears to be proper, and his action in reducing the invested capital to the adjusted cost of the real estate in question is sustained. An examination of the record does not show that satisfactory evidence has been submitted by the corporation establishing the value of the real estate transferred to the new corporation in 1917 in excess of the adjusted cost. Therefore it is recommended that the adjustment made by the revenue agent and accepted by the Unit be affirmed.

In the examination of this case the revenue agent has apparently erred by treating the return filed by the corporation under the first two sentences of article 206 of Regulations 33, revised, which reads as follows:

A mere change in name does not constitute a new corporation. If the business was continuous throughout the year, no change in management or operation other than the change in name having occurred, the return should be made covering the business transacted throughout the year, such return to be made by the corporation in the name which it bears at the end of the year, with a notation on the return to the effect that the name had been changed, giving both the old and the new names. If, however, a distinctly new corporation was organized to take over the property of the old, both corporations will be required to make separate returns covering the periods of the year during which they were respectively in charge of the business.

It appears that a new corporation was created to take over the assets of the old corporation, that the authorized capital stock was increased, and that by the new charter the new corporation was authorized to hold title to real estate. A distinctly new corporation came into existence, which took over the property of the old corporation; therefore, both the old and the new corporations will be required to file separate returns covering the periods of the year during which they were in active control of the business. The last sentence of the above-quoted article of the regulations in the judgment of the Committee covers the situation in the instant case. Therefore it is recommended that the action of the Income Tax Unit accepting the revenue agent's recommendation on this point be reversed and that both the old and the new corporations be required to render separate returns for the respective periods of the year. It is also suggested that the net earnings, if any, of the Massachusetts corporation from January 1 to the date of dissolution be included as part of the invested capital of the newly organized corporation for the period for which a return is rendered.

5-21-1424: O. D. 789.

The M Company was incorporated for the purpose of acquiring that part of the business of the N Company, a foreign corporation, which it carried on in the United States and Canada.

The M Company issued common and preferred stock to the N Company, in the amount of  $x$  dollars, in exchange for its business in the United States and Canada. The domestic corporation requested permission to set up on its books as invested capital several increases over the amounts carried on its books for the same items by the foreign corporation.

Held, that where a foreign corporation has been taxed on its activities in this country, and its activities in Canada and this country are subsequently taken over by a domestic corporation organized for that purpose, and fifty per centum or more of the stock of the domestic corporation is held by the foreign corporation, the assets of the domestic corporation are to be valued under section 331, Revenue Act of 1918. In the case presented the domestic corporation may set up on its books as invested capital the assets taken over from the foreign corporation at such values as could have been established had the previous owner been required to set up invested capital as a domestic corporation.

8

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(See 8-21-1470; Section 326, Article 831.) Valuation of assets upon a reorganization and the changing of a partnership into a corporation.

9

11-21-1512: A. R. R. 409.

The Committee has had under consideration the appeal of the M Corporation from the action of the Income Tax Unit in denying the corporation an item of  $x$  dollars, or the statutory percentage thereof, carried on the books of the corporation as "good will, trade-marks, and foreign agencies."

The M Corporation was incorporated April, 1917, with a capital stock of 100y shares, taking over the net assets of the N partnership as a going concern as of January 1, 1917, and in addition thereto the sum of  $x$  dollars in cash. The consideration for the net assets of the partnership and the additional cash was the sum of  $4x$  dollars to be paid by the corporation issuing to the partners, or to their nominees, the entire issue of capital common stock of the corporation consisting of 100y shares. Certain adjustments were made of salaries of the partners to offset the credit for earnings from January 1, 1917, to April, 1917. The journal entry made to open the books of the corporation was in the following expression:

Net value of the tangible assets of the partnership.....	2x dollars	
Cash to be paid in.....	x dollars	
Good will, trade-marks, and foreign agencies.....	x dollars	
To capital stock.....		4x dollars

The partnership books were not closed, and, on advice of accountants, they became the books of the corporation, subject, however, to the above corporate entry.

At a meeting of the board of directors of the corporation held April, 1917, the following resolution was adopted:

RESOLVED, That upon the execution and delivery to this company of the instruments enumerated and upon the payment by A, B and C to this corporation of said sum of  $x$



dollars in cash, in accordance with the terms of said written proposal of April, this corporation, issued to said A, B, and C the entire issue of the capital stock of this corporation, to-wit, 100y shares, as provided for in said written proposal of said M Corporation dated April, 1917, and as accepted by the board of directors of this company at the board meeting held in April, 1917.

The following abstract and resolution are quoted from the minutes of a meeting of the corporation held April, 1917:

That said A, B, and C had presented a list of the nominees in whose names they desired that said capital stock should be issued, showing the name, address, and number of shares of stock to be issued to each person, firm, or corporation.

On motion, duly seconded, the following resolution was duly adopted:

RESOLVED, That the said list be set forth in full in these minutes and that as said A, B, and C had complied with their said offer of April, 1917, and had duly transferred all of the property and assets of said N partnership to this corporation, and had paid in to this corporation said additional sum of x dollars in cash, the certificates of stock prepared for that purpose be issued to said persons accordingly as the original issue of the shares of the capital stock of this corporation.

Of the 100y shares of stock issued by the corporation, the following shares were authorized by the officers of the corporation to be recorded by the transfer agent in the names of the former partners:

B.....	18y shares
C.....	10y shares
A.....	21y shares
Total.....	49y shares

or a few shares less than 50 per cent of the total issue of stock to them. According to the records of the transfer agent, the remaining shares were issued to the stockholders in number from 1 to 25y shares. The stock issued to the public was very well distributed. In the corporate organization B became president and general manager, C vice-president and secretary, and A chairman of the board of directors and treasurer of the corporation.

Section 208 of the Revenue Act of 1917 provides:

That in case of the reorganization, consolidation, or change of ownership of a trade or business after March third, nineteen hundred and seventeen, if an interest or control in such trade or business of fifty per centum or more remains in control of the same persons, corporations, associations, partnerships, or any of them, then in ascertaining the invested capital of the trade or business no asset transferred or received from the prior trade or business shall be allowed a greater value than would have been allowed under this title in computing the invested capital of such prior trade or business if such asset had not been so transferred or received, unless such asset was paid for specifically as such, in cash or tangible property, and then not to exceed the actual cash or actual cash value of the tangible property paid therefor at the time of such payment.

Article 50 of Regulations 41 substantially follows the language of the Act. It would appear, therefore, that the sole question at issue rests upon the intent of the words "remains in control" as used in the Act. It is clear from the above facts that the partners who became the principal officers of the corporation continued in position to exercise direct and effective control over the affairs of the business. The corporate books were in the hands of one of the former partners and from this record he had intimate knowledge of the ownership of stock held by outside interests.

Apart from this effective control it is clear that by agreement and bill of sale the partners received the entire capital stock of the corporation for the net partnership assets and for other valuable considerations. This gave the partners immediate authority to dispose of such stock in any manner they might desire. Technically, the proceeds from the sale of any or all of the stock passed to the partnership. Out of these proceeds the partners paid to the corporation such amount or amounts as the partners had agreed to pay in part consideration for the stock received by them. In other words, the transaction was between the corporation and the partners and the latter named

the proportion in which they desired the stock distributed to them and to their nominees. Hence, the partners did remain in control. They exercised this control in naming their nominees. It is immaterial that this stock control was not continuing—that it immediately passed by a small fraction into other hands.

In oral argument representatives of taxpayer laid stress on the amounts which had been expended by the partnership from time to time in developing foreign agencies. The Committee finds no provision in the law or regulations for the capitalization of such items which were invariably charged, and properly so, to cost of conducting the business.

Article 64 of Regulations 41 provides:

Amounts expended in the past for good will, trade-marks, trade brands, franchises, and other intangible assets of a like character, are controlled by the language of the statute which provides that such assets "shall be included in invested capital if the corporation or partnership made payment bona fide therefor specifically as such in cash, or tangible property." The Commissioner of Internal Revenue will recognize additions to invested capital on account of intangible assets only if such assets have been explicitly paid for in the manner prescribed by the statute. Where expenditures have been made for the general development of intangible assets, and charged as current expense, no readjustment thereof will be allowed.

It is, accordingly, the recommendation of the Committee that the action of the Income Tax Unit in disallowing this corporation  $x$  dollars, or any part thereof, as "good will, trade-marks and foreign agencies" be sustained under section 208 of the Revenue Act of 1917.

10

39-21-1849: A. R. R. 618.

Recommended, in the case of the M Company, that the action of the Income Tax Unit in disallowing an item of good will under section 331 of the Revenue Act of 1918 be sustained, and that the action of the Income Tax Unit be also sustained under section 310 in declining the request of this appellant to use other years than the years 1911, 1912 and 1913 in establishing average prewar income for war profits tax purposes.

The Committee has had under consideration the appeal of the M Company from the action of the Income Tax Unit in disallowing in the statutory invested capital of this corporation a good will item of  $10x$  dollars and in declining to consider certain years other than the years 1911, 1912 and 1913 in arriving at the average prewar income for war profits tax purposes.

The M Company was incorporated in 1918, taking over the net tangible assets of the partnership of O & Company. For the net tangible assets of the partnership there was issued  $25x$  dollars of preferred stock of the corporation and  $10x$  dollars of common stock. The stock of both issues was delivered to the partners of O & Company in consideration for their partnership interests and the par value of the common stock, namely,  $10x$  dollars, which was in excess of the value of the net tangible assets of the partnership, was charged to good will on the books of the corporation. That item was eliminated from invested capital by the Income Tax Unit under authority of section 331 of the Revenue Act of 1918 and article 941 of Regulations 45 because more than 50 per cent of the interest or control in the partnership continued in the same persons as stockholders of the corporation.

The appellant states that the partnership of O & Company had been operating successfully for approximately sixty years and that during this period it earned the good will of both the public and the trade on account of the sterling integrity of the members of the firm in their business relations, together with the maintenance of an unsurpassed standard of quality of



merchandise offered for sale, It is contended that such good will thus established should be considered as entirely separate and distinct from the good will created through the medium of advertising and development of the trade-name brands of goods and that accordingly in addition to the "cost of acquisition," as stated in section 331 of the Revenue Act, there should be taken into account not merely "betterments" represented by actual cash outlay for advertising, etc., but a positive additional value represented by the gradual development of the good will value during the years, which must be measured in terms of profits earned.

It does not seem necessary to give consideration to the going concern value of this business as may be determined by its income over a period of years. Section 331 of the Act and article 941 of the Regulations are explicit enough in limiting the value of the assets of a trade or business reorganized after March 3, 1917, to the value of the assets of the predecessor company when there is an interest of 50 per cent or more remaining in the same persons. In the instant case the continuing interest was 100 per cent. Accordingly, under the mandate of the law itself, no recognition can be given in the instant case to the alleged value of good will measured by the capital stock of the corporation issued in excess of the value of the net assets, both tangible and intangible, of the predecessor partnership.

It appears, however, that in 190- there was a partnership reorganization and at this time, by agreement, there was set up on the books of the new partnership an item of  $\frac{1}{2}x$  dollars for good will of the business of O & Company. This item, however, was written off the books of the partnership prior to the incorporation of the business in July, 1918. It would seem, under section 331 of the Act, that if the value of this asset can be established by cost of acquisition at the time of reorganization of the partnership in 190-, the partnership should have the right to restate its proprietary interest so that the item of  $\frac{1}{2}x$  dollars would be reflected as an asset at the date of incorporation of the partnership and accordingly allowed as an intangible asset on the books of the corporation.

With respect to the contention of the appellant that other years than the years 1911, 1912 and 1913 be used for the purpose of establishing prewar income, it is noted that the contention rests on the fact that in the year 1913 great quantities of the product handled were sold by a foreign government in the American market at a stated price with the immediate effect that its value declined considerably. This contention, however, was not peculiar to this appellant. It is admitted that the act of the foreign government affected approximately all American concerns engaged in the same business. It is admitted, therefore, that while this was an unusual year of depression, all like trades were affected to the same extent as that of the appellant. Relief, which is sought by the appellant under section 205 of the Revenue Act of 1917, does not obtain and the point at issue must be disposed of under the mandatory provisions of section 310 of the Revenue Act of 1918, which prescribes the years 1911, 1912 and 1913 as the prewar period.

The Committee, therefore, recommends, in the case of the M Company, that the action of the Income Tax Unit in disallowing an item of good will under section 331 of the Revenue Act of 1918 be sustained, and that the action of the Income Tax Unit be also sustained under section 310 in declining the request of this appellant to use other years than the years 1911, 1912 and 1913 in establishing average prewar income for war profits tax purposes.

43-21-1890: A. R. R. 645

Recommended in the appeal of the M. Company, that the action of the Income Tax Unit be sustained in holding that A did not retain an interest or control of 50 per cent or more in the trade or business previously owned and engaged in by him under the name of X, and that the case does not come within the provisions of section 208 of the Revenue Act of 1917, and article 50 of Regulations 41 and section 331 of the Revenue Act of 1918 and article 941 of Regulations 45.

The Committee has had under consideration the appeal of the M Company from the action of the Income Tax Unit in holding that A did not retain an interest or control of 50 per cent or more in his individual trade or business transferred to the foregoing corporation on or about December—, 1917, and that the provisions of section 208 of the Revenue Act of 1917 and section 331 of the Revenue Act of 1918 do not apply.

The tax returns of this corporation are under audit for the years 1917, 1918, and 1919, and the question under consideration by the Committee arose in connection with the audit.

The Committee, after examining the facts in the case and the arguments presented by attorneys for the corporation, reached the conclusion that the appeal raised a question of law. An opinion was requested from the Solicitor, and the Committee is now in receipt of an opinion, which reads as follows:

In December, 1917, A was the owner of a certain business, which he engaged in under the name of X. In that month his son, B, together with two other persons, formed a corporation known as the M Company for the purpose of acquiring the assets of the business conducted by A so that the business might be continued by the corporation. On December —, 1917, A offered to sell to the corporation all his right, title, and interest in and to the assets of the business that had been conducted by him, in consideration of the issuance of  $48\frac{3}{4}y$  shares of stock of the corporation to seven persons, who were named in the offer. A was to receive  $\frac{1}{2}y$  shares, his children and close connections were to receive the remainder. The corporation was authorized to issue not more than 50y shares of stock under its charter. The offer was accepted by the corporation. The assets were then transferred to the corporation and the stock was issued to the designated persons in accordance with the agreement, with the exception of two qualifying shares issued to other persons. After the consummation of this transaction A held  $1\frac{1}{2}y$  shares of the corporate stock, y shares being purchased by him for cash.

Two questions are raised (1) whether the transaction in question constituted a reorganization of the business or a sale of the business to the corporation, and (2) whether an interest or control of 50 per cent or more of the business remained in A, the owner of the business prior to its transfer to the corporation.

Section 208 of the Revenue Act of 1917 provides:

That in case of the reorganization, consolidation, or change of ownership of a trade or business after March third, nineteen hundred and seventeen, if an interest or control in such trade or business of 50 per centum or more remains in control of the same persons, corporations, associations, partnerships, or any of them, then in ascertaining the invested capital of the trade or business no asset transferred or received from the prior trade or business shall be allowed a greater value than would have been allowed under this title in computing the invested capital of such prior trade or business if such asset had not been so transferred or received, unless such asset was paid for specifically as such, in cash or tangible property, and then not to exceed the actual cash or actual cash value of the tangible property paid therefor at the time of such payment.

Section 331 of the Revenue Act of 1918 reads as follows:

In the case of the reorganization, consolidation, or change of ownership of a trade or business, or change of ownership of property, after March 3, 1917, if an interest or control in such trade or business or property of 50 per centum or more remains in the same persons, or any of them, then no asset transferred or received from the previous owner shall, for the purpose of determining invested capital, be allowed a greater value than would have been allowed under this title in computing the invested capital of such previous owner if such asset had not been so transferred or received: *Provided*, That if such previous owner was not a corporation, then the value of any asset so transferred or received shall be taken at its cost of acquisition (at the date when acquired by such previous owner) with proper allowance for depreciation, impairment, betterment, or development, but no addition to the original cost shall be made for any charge or expenditure deducted as expense or otherwise on or after March 1, 1913, in computing the net income of such previous owner for purposes of taxation.



The taxpayer states that the decision of this case rests upon the construction to be given to the words "interest or control," "remains in the same person," and "remains in control." These are said to be the key words to the whole matter. It is contended that the fact that A named persons of his own family to receive the stock of the corporation is immaterial in determining the question of control, as the transaction was entirely bona fide and no question of fraud or evasion is involved.

The solution of the principal question presented lies in the effect to be given to the contract arising from the acceptance by the corporation of the offer by A under date of December —, 1917.

In a majority of the States, where two parties enter into an agreement upon a valid consideration and thereunder third persons are to receive a benefit, the contract may be enforced by such third persons. The transaction in question took place in the State of Illinois, and this principle has been recognized by the courts of that State. It was stated by the Supreme Court of that State in *Cobb v. Heron*, 180 Ill. 49, 54 N. E. 189, Aff. 78 Ill. App. 654, that privity or consideration between a promisor and a third person who is a beneficiary under a contract need not exist to support a promise, provided there is a valuable consideration for the promise as between the principal parties to the undertaking, citing *Deen v. Walker*, 107 Ill. 540; *Bay v. Williams*, 112 Ill. 91. This principle has also been asserted in numerous cases including the following: *Hartman v. Pistorious*, 248 Ill. 568, 94 N. E. 131; *Searls v. Flora*, 225 Ill. 167, 80 N. E. 98; *Harms v. McCormick*, 132 Ill. 104, 22 N. E. 511. Under this rule then, which is sustained by sufficient authority, the moment the offer of A was accepted by the corporation a binding contract for the benefit of the third parties was affected.

As A chose to specify in his offer the persons who were to receive the stock, which, on acceptance by the corporation, obligated it to issue the shares to the persons designated (which obligation was promptly carried out), it is clear that the limitations of the statute do not apply, notwithstanding the relationship existing between A and the persons whom he designated to receive the stock, provided the transaction was bona fide and not designed to conceal the real ownership of the stock.

It appears from the evidence that the transaction was bona fide. An explanation of the transaction lies in the fact that A desired to provide for his children during his own lifetime and retire from active business. Almost immediately after he transferred the assets of his individual business to the corporation he retired from business and died about two months later. There seems to be no doubt that the issuance of the stock to the persons designated in the offer was absolute and unconditional and that A made no attempt to retain any interest, either directly or indirectly, in the stock.

For these reasons it is the opinion of this office that A did not retain an interest or control of 50 per cent or more in the trade or business previously owned and engaged in by him under the name of X and that, therefore, the case does not come within the provisions of section 208 of the Revenue Act of 1917 and section 331 of the Revenue Act of 1918.

It is immaterial in determining the question of invested capital whether the transaction in question constituted a sale or reorganization, and no opinion in connection therewith is expressed.

In view of the foregoing opinion of the Solicitor, in which the Committee concurs, it is recommended that the action of the Income Tax Unit be sustained in holding that A did not retain an interest or control of 50 per cent or more in the trade or business previously owned and engaged in by him under the name of X and that the case does not come within the provisions of section 208 of the Revenue Act of 1917 and article 50 of Regulations 41 and section 331 of the Revenue Act of 1918 and article 941 of Regulations 45.

12

45-21-1916: O. D. 1097.

In 1913, the M Company was required by order of court to dissolve. Prior to such dissolution, a new corporation, known as the O Company, was was organized with a capital stock equal to the aggregate par value of the capital stock of the M Company outstanding. The O Company then exchanged its capital stock (aggregate par value 3x dollars) for all the stock, assets, and liabilities of the M Company. At the time of such sale the M Company had capital stock outstanding of a total par value of 3x dollars, surplus and undivided profits, x dollars. The stock of the new company

was issued share for share to the stockholders who held the stock of the old company. The officers and directors of the old company and the new company are identical.

The question presented is whether in computing invested capital of the O Company the value of the assets as carried on the books of the M Company may be taken up on its books and included at the same rate they were so carried on the books of the M Company.

Held, that a change of entity occurred resulting in a new and distinct corporation and that as the property acquired for stock, including surplus and undivided profits, was paid in prior to January 1, 1914, pursuant to section 207 (a) of the Revenue Act of 1917, the tangible property received by the O Company may be included in invested capital at its actual cash value as of January 1, 1914, to the extent that such value is not in excess of the par value of stock or shares specifically issued therefor.

13

## I (22)—3-39: L. O. 1081.

## INCOME TAX—SECTION 331, REVENUE ACT OF 1918.

Section 331 of the Revenue Act of 1918 is not made inapplicable because of the fact that a control of 50 per cent or more in the trade, business, or property reorganized, consolidated, or transferred subsequent to March 3, 1917, does not remain in any of the previous owners, provided such control does remain in the same persons or any of them.

Where section 331 applies to the transfer of assets from one corporation to another, the assets transferred shall be valued, for invested capital purposes, in accordance with the provisions of section 326, provided such values do not exceed the allowed value, for invested capital purposes, of the assets if such assets had not been transferred.

Article 941 of Regulations 45 should be amended to conform herewith.<sup>1</sup>

The question has arisen as to whether article 941 of Regulations 45 contains the correct interpretation of section 331 of the Revenue Act of 1918.

Section 331 of the Revenue Act of 1918 provides as follows:

Sec. 331. In the case of the reorganization, consolidation, or change of ownership of a trade or business, or change of ownership of property, after March 3, 1917, if an interest or control in such trade or business or property of 50 per cent or more remains in the same persons, or any of them, then no asset transferred or received from the previous owner shall, for the purpose of determining invested capital, be allowed a greater value than would have been allowed under this title in computing the invested capital of such previous owner if such asset had not been so transferred or received: *Provided*, That if such previous owner was not a corporation, then the value of any asset so transferred or received shall be taken at its cost of acquisition (at the date when acquired by such previous owner) with proper allowance for depreciation, impairment, betterment, or development, but no addition to the original cost shall be made for any charge or expenditure deducted as expense or otherwise on or after March 1, 1913, in computing the net income of such previous owner for purposes of taxation.

Article 941 of Regulations 45, which interprets section 331, reads:

Art. 941. Where a business is reorganized, consolidated, or transferred, or property is transferred, after March 3, 1917, and an interest or control of 50 per cent or greater in such business or property remains in any of the previous owners, then for the purpose of determining invested capital each asset so transferred is valued (a) as if still in the possession of the previous owner, if a corporation, or, if not a corporation, (b) at its cost to such previous owner, with proper adjustments for losses and improvements. This provision is accordingly concerned with the computation of invested capital for the taxable year, while section 330 of the statute is chiefly concerned with the determination of invested capital for the prewar period.

<sup>1</sup> Treasury Decision 3259 (Bulletin 51-21, p. 17), amending article 941 of Regulations 45, is based on Law Opinion 1081.



The validity of article 941, in so far as it provides that section 331 applies only when an interest or control of 50 per cent or more remains "in any of the previous owners," has been questioned.

The following hypothetical case, which is merely illustrative of actual cases which have arisen, has been presented. The N corporation transfers to O corporation, subsequent to March 3, 1917, tangible property in exchange for 20 per cent of its stock. Seventy-five per cent of the stock of corporations N and O is owned by the same individual but the corporations are not affiliated.

It is apparent in this case that an interest or control of 50 per cent or more in the property does not remain after the exchange "in any of the previous owners," inasmuch as the N corporation, the previous owner of the asset, owns only a small proportion of the outstanding stock of the O corporation. Thus, if article 941 correctly interprets this section of the statute, the O corporation can include in invested capital the actual value of the property exchanged, subject to the limitations contained in section 326, even if such value is in excess of the allowable value for invested capital purposes of the property to the N corporation.

Section 331, however, limits the amounts to be included in the invested capital of the new owner if an interest or control in the property of 50 per cent or more "remains in the same persons or any of them." In the case stated above it is apparent that, by virtue of stock holdings, a control in excess of 50 per cent in the property transferred "remains in the same persons," i. e., the stockholders of the N and O corporations.

Article 941 of Regulations 45, therefore, is incorrect, in so far as it provides that in order that section 331 be applicable an interest or control of 50 per cent or more in the property exchanged must remain in the previous owners.

Article 941 provides further that where section 331 applies the property transferred, if transferred by a corporation, is valued, for the purpose of determining invested capital, as if still in the possession of the previous owner.

The provisions of article 941 on this point can be most clearly shown by application to a specific case: The N corporation, which owned 50 per cent of the outstanding stock of the O corporation, transferred subsequent to March 3, 1917, unimproved real estate, which cost it \$100,000 but which at the time of the exchange, due to a decrease in market value, was worth only \$20,000, to the O corporation in exchange for stock. Under the provisions of article 941 the asset so transferred should be valued, for the purpose of determining the invested capital of the O corporation, "as if still in the possession of the previous owner." That is, the O corporation should include in invested capital, on account of the asset transferred, \$100,000, the allowable value of the asset, provided for invested capital purposes, to the N corporation, in spite of the fact that the actual cash value of the asset at the time of the exchange was only \$20,000.

Section 326 provides that invested capital includes "the actual cash value of tangible property other than cash, bona fide paid in for stock or shares, *at the time of such payment* \* \* \*." Section 331 makes an exception to this general rule in the case of a change of ownership of property between corporations subsequent to March 3, 1917, where an interest or control of 50 per cent or more remains in the same persons, and provides that in such case the property transferred shall not be allowed a greater value, for invested capital purposes, "than would have been allowed \* \* \* in computing the invested capital of such previous owners \* \* \*." In the case stated above,

the asset paid into the O corporation for stock should be included at its actual cash value at the time paid in, under the provisions of section 326 unless the case falls within the exception covered by section 331. This latter section merely provides, however, that an asset so transferred shall not be allowed a greater value than would have been allowed the previous owner, if a corporation, and is, therefore, by its own terms, inoperative unless the actual cash value of the property at the time of the exchange is in excess of the allowable value of the property, for invested capital purposes, in the hands of the previous owner. Inasmuch as the actual cash value of the asset transferred, in the instant case, was \$20,000, a lesser amount than the allowable value of the asset, for invested capital purposes, in the hands of the N corporation, section 331 is not operative. Therefore the O corporation should include in invested capital, under section 326, \$20,000, the actual cash value of the asset at the time paid in for stock.

It is concluded that:

(1) Section 331 of the Revenue Act of 1918 is not made inapplicable because of the fact that a control of 50 per cent or more, in the trade, business, or property reorganized, consolidated, or exchanged, subsequent to March 3, 1917, does not remain in any of the previous owners, provided such control does remain in the same persons, or any of them.

(2) Where section 331 applies to the transfer of assets from one corporation to another, the assets transferred shall be valued, for invested capital purposes, in accordance with the provisions of section 326, provided such value does not exceed the allowable value, for invested capital purposes, of the assets, if such assets had not been transferred.

Article 941 of Regulations 45 should be amended to conform herewith

CARL A. MAPES,  
*Solicitor of Internal Revenue.*

14

(See I ('22)-4-48; Section 326, Article 831. Ruling No. 32.) Exchange by domestic corporation of tangible property for majority of stock of foreign corporation. Revenue Acts of 1917 and 1918.

15

I('22)-14-206: A. R. R. 844.

#### Revenue Act of 1917.

Recommended, in the appeal of the M Company, that the action of the Income Tax Unit in holding that the reincorporation of the appellant company in 1914 under the laws of the State of Y did not constitute such a reorganization as would permit that company to claim a greater amount of statutory invested capital for the year 1917 than would have been allowed had that company continued to operate under the charter granted by the State of Z, be sustained, and that it be held that such a reorganization did take place in 1902 and the appellant company's statutory invested capital for the year 1917 be recomputed upon the basis of the values existing at the time of such reorganization.

The Committee has had under consideration the appeal of the M Company from the action of the Income Tax Unit in reducing the amount of invested capital claimed by the appellant for the year 1917. The question at issue and the facts in the case are stated in a memorandum of the Unit as follows:

The question is: Shall the taxpayer be permitted to include in invested capital a paid-in surplus of 15x dollars (net) representing the excess of actual value of tangible assets over the par value of stock issued therefor at the time of the alleged reorganization De-



cember —, 1914, and also include in invested capital good will in the amount of 20 per cent of the outstanding stock on March 3, 1917?

Facts:

The business was established in 187— by A. He conducted it individually until 189—, when the M Company (the first M Company by that name) was organized with an authorized capital stock of 4x dollars.

In July, 1902, the M Company (of Z) was organized, with an authorized capital stock of 40x dollars, acquiring the business and good will of the first M Company of Y. It was at the time immediately prior to the organization of the M Company of Z that the item of good will made its appearance on the books of the old M Company. The item of good will did not appear in the balance sheet of the M Company of Y in January, 1902, but was set up in the July balance sheet at  $18\frac{1}{2}x$  dollars. Immediately thereafter the business was transferred to the M Company of Z. At the time of creating the item of good will on the books of the old M Company the stock was not increased but an asset of good will was created and a corresponding credit was made to surplus.

The M Company of Z continued in business until 1914, in the meantime increasing its capital stock to 50x dollars.

Under date of December —, 1914, the present M Company of Y was organized, with an authorized capital stock of 50x dollars. This stock was issued to the shareholders of the predecessor M Company of Z share for share. The assets of the old company were transferred to the new company and continued on its books without change in value.

In its return the taxpayer claimed invested capital computed as follows:

	Dollars.
Capital stock.....	50x
Surplus earned since 1902.....	12x
<hr/>	
Add under Schedule B—Paid-in surplus at date of organization of second M Company of Y in 1914 based on excess of actual value of tangible assets over book value at that date.....	15½x
	77½x
Deduct under Schedule C—Excess of book value of good will over 20 per cent limitation.....	8½x
Depreciation not charged off.....	¾x
	9¼x
	68¼x
Add under Schedule D—Additional issues of stock during taxable year	16x
	84¼x
Invested capital.....	84¼x

The Income Tax Unit, by letter of April —, 1919, recomputed the invested capital as follows:

	Dollars
Capital stock.....	50x
Surplus earned from December, 1914, to Dec. 31, 1916.....	8¼x
<hr/>	
Additions under Schedule D for additional capital stock issued during taxable year.....	16x
	74¼x

The elimination of paid-in surplus was based on the theory that, granting the values claimed by the company for its tangible assets at date of organization in 1914, it followed that the entire stock of 50x dollars was issued for tangible property and that the paid-in surplus, therefore, represented intangible assets and could not be allowed. See article 63, Regulations 41, which permits a paid-in surplus only with respect to tangible property.

The Income Tax Unit, by letter of June —, 1920, made a further adjustment in the company's invested capital, the reason therefor not being pertinent to the present inquiry. Said letter adhered to the former action in the disallowance of good will.

It is appropriate at this step to invite attention to the fact that the record indicates that the Advisory Tax Board passed upon the item of paid-in surplus, the decision being adverse to the taxpayer. A formal ruling by the Board, however, does not appear in the record.

The company has rebutted the finding that the paid-in surplus represented intangible assets. In this connection see pages 8 and 9 of the brief showing that the opening entries on the books in 1914 recite that the capital stock of the M Company, then organized, was issued specifically for good will in the amount of  $18\frac{1}{2}x$  dollars, and furthermore that the certificate of issue of capital stock filed with the State of Y discloses that  $18\frac{1}{2}x$  dollars of the 50x dollars of capital stock was specifically issued for the asset good will.

In rendering its tax returns for the year 1917 the appellant took the position that there had been a reorganization of the company in 1914 and that the value of the assets transferred to it by the M Company of Z at the time of such transfer should be taken as a basis for the establishment of the amount of statutory invested capital allowable in the computation of its profits tax liability for the year 1917. The Unit in disallowing a portion of the amount of invested capital claimed for that year took the position that inasmuch as the assets of the M Company of Z were taken over by the new M Company of Y without any change in value and without any change in business or amount of capitalization, with the stockholders of the new M Company of Y the same as those of the M Company of Z, there was no such reorganization in 1914 as would permit the M Company to value its assets for invested capital purposes at a greater amount than would its predecessor company be permitted to have valued its assets had it continued to operate under the charter granted by the State of Z.

As appears from the records in the case, the surrender of the M Company's Z charter and its acquirement of a Y charter effected merely a change in domicile and charter without any accompanying change in business, capitalization, surplus, or stock ownership, and therefore the Committee, adhering to the opinion expressed by it relative to a very similar case previously considered, as set forth in A. R. R. 16 (C. B. 2, p. 312), recommends that the action of the Unit in holding that the reincorporation of the M Company in 1914 under the laws of the State of Y did not permit that company to claim a greater amount of statutory invested capital for the year 1917 than would have been allowed had that company continued to operate under the charter issued by the State of Z, be sustained.

However, as shown by the records, there was a decided change in capitalization as well as a change in domicile and character in 1902 when the M Company surrendered its first Y charter and reincorporated under the laws of the State of Z. At the time of such surrender the company was capitalized at 4x dollars, and it was reincorporated with an authorized capital of 40x dollars. Taking this fact into consideration, the Committee is of the opinion that a reorganization took place in 1902, and that the company's statutory invested capital for the year 1917 should be recomputed upon the basis of the values existing at the time of such reorganization, with particular care given to the ascertainment of the value of the good will of the company as of July —, 1902, the date upon which it appears the said reorganization was effected, and to the ascertainment of the value of the leaseholds, if any, which were transferred by the first M Company to the M Company of Z on that date.

In view of the foregoing, the Committee recommends that the action of the Income Tax Unit in holding that the reincorporation of the M Company in 1914 under the laws of the State of Y did not constitute such a reorganization as would permit that company to claim a greater amount of statutory invested capital for the year 1917 than would have been allowed had that company continued to operate under the charter granted by the State of Z, be sustained, and that it be held that such a reorganization did take place in 1902 and that the company's statutory invested capital for the year 1917 be recomputed upon the basis of the values existing at the time of such reorganization.



I('22)-29-417: A. R. R. 988

**Act of October 3, 1917, Section 208. Act of February 24, 1919, Section 331.**

Recommended, in the appeal of the M Company, that the action of the Income Tax Unit in requiring the appellant to file amended returns for the taxable years affected pursuant to Treasury Decision 3220 (C. B. 5, p. 285), be sustained.

The Committee has carefully considered the oral appeal of the M Company from the action of the Income Tax Unit in requiring it to file amended returns for the taxable years affected, pursuant to the provisions of Treasury Decision 3220. [¶865 herein.]

The M Company was organized under the laws of the State of Y in 1897 and its charter expired in accordance with its terms in September, 1917. The corporation commissioner of the State of Y having held that under section 6705 of the State of Y Laws the existence of a corporation could not be continued by the filing of supplemental articles of incorporation, the M Company was organized September, 1917, with an authorized capital stock of 30x dollars, which was the same as that of the original company. The stock of the new company was issued to the stockholders of the original company share for share, and all the assets of the old corporation were thereupon transferred to the new corporation at their market value as of September, 1917, and such value was utilized in the preparation of the tax returns of the company. Under date of February —, 1922, demand was made upon the company that it file amended returns for the taxable years affected by the use of such increased invested capital in accordance with the provisions of Treasury Decision 3220 (C. B. 5, p. 285).

Owing to the peculiar circumstances existing in this case the appellant was allowed to file an oral appeal, and argument by its representatives was heard by the Committee on April —, 1922. It is contended by the appellant that the purpose and intent of section 208 of the Act of October 3, 1917, and section 331 of the Act of February 24, 1919, were to prohibit the inflation of the invested capital of a corporation through a voluntary reorganization, and that these sections should not apply to a case like the present, in which the reorganization or change of ownership was wholly involuntary and due solely to the expiration of the charter of the original corporation. It was admitted by the representatives of the appellant at the oral hearing that the assets of the original corporation were never actually distributed to the stockholders but were transferred directly by deed of the original corporation to the new corporation.

• Section 208 of the Act of October 3, 1917, provides:

That in the case of the reorganization, consolidation, or change of ownership of a trade or business after March 3, 1917, if an interest or control in such trade or business of 50 per centum or more remains in control of the same persons, corporations, associations, partnerships, or any of them, then in ascertaining the invested capital of the trade or business no asset transferred or received from the prior trade or business shall be allowed a greater value than would have been allowed under this title in computing the invested capital of such prior trade or business if such asset had not been so transferred or received, unless such asset was paid for specifically as such, in case or tangible property, and then not to exceed the actual cash or actual cash value of the tangible property paid therefor at the time of such payment.

The same provision, with certain modifications which are not here material, was enacted as section 331 of the Act of February 24, 1919.

Section 6699 of the State of Y Laws provides that:

All corporations that expire by limitation specified in their articles of incorporation, \* \* \* continue to exist as bodies corporate for a period of five years thereafter, if necessary for the purpose of prosecuting or defending actions, suits, or proceedings by or against them, settling their business, disposing of their property, and dividing their capital stock, but not for the purpose of continuing their corporate business.

Supplementary Bulletin Rulings.

An examination of section 6705 of the State of Y Laws leads the Committee to concur in the opinion of the corporation commissioner of the State of Y that the existence of the original corporation could not have been continued by the filing of supplemental articles of incorporation, and that, therefore, the M Company constituted a new and separate corporation, but under the provisions of section 6699 the assets of the original corporation did not upon the expiration of its charter automatically revert to the stockholders, but the corporation continued for the purpose of winding up its affairs, and in accordance with the powers thus continued to it, its assets were conveyed to the new corporation.

Without attempting to characterize the proceedings in this case, it is clear that there was a change of ownership of a trade or business" or "a change of ownership of property," occurring after March 3, 1917, and not only 50 per centum but 100 per centum of the interest or control remained in the same persons. This case, therefore, clearly falls within the language of both sections 208 of the Act of October 3, 1917, and section 331 of the Act of February 24, 1919, and it does not appear to the Committee that it is outside the purpose and intent of those sections. The sections of the statutes themselves contain no exception in the case of an involuntary change of ownership and it seems clear the intent of Congress was to prevent the increase of the invested capital of a corporation by including therein appreciation in the value of its assets upon a change of ownership which was nominal and not substantial.

The Committee, therefore, finds that the appeal in this case is without merit and accordingly recommends that the action of the Income Tax Unit in requiring the M Company to file amended returns for the taxable years affected, pursuant to Treasury Decision 3220, be sustained.

17

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(See A. R. M. 192; sec. 326, art. 836-27-17, herein.) Property acquired at receiver's sale by creditors or stockholders of old or new corporation or both subsequent to March 3, 1917.

18



I('22)-29-417: A. R. R. 988

**Act of October 3, 1917, Section 208. Act of February 24, 1919, Section 331.**

Recommended, in the appeal of the M Company, that the action of the Income Tax Unit in requiring the appellant to file amended returns for the taxable years affected pursuant to Treasury Decision 3220 (C. B. 5, p. 285), be sustained.

The Committee has carefully considered the oral appeal of the M Company from the action of the Income Tax Unit in requiring it to file amended returns for the taxable years affected, pursuant to the provisions of Treasury Decision 3220. [¶865 herein.]

The M Company was organized under the laws of the State of Y in 1897 and its charter expired in accordance with its terms in September, 1917. The corporation commissioner of the State of Y having held that under section 6705 of the State of Y Laws the existence of a corporation could not be continued by the filing of supplemental articles of incorporation, the M Company was organized September, 1917, with an authorized capital stock of 30x dollars, which was the same as that of the original company. The stock of the new company was issued to the stockholders of the original company share for share, and all the assets of the old corporation were thereupon transferred to the new corporation at their market value as of September, 1917, and such value was utilized in the preparation of the tax returns of the company. Under date of February —, 1922, demand was made upon the company that it file amended returns for the taxable years affected by the use of such increased invested capital in accordance with the provisions of Treasury Decision 3220 (C. B. 5, p. 285).

Owing to the peculiar circumstances existing in this case the appellant was allowed to file an oral appeal, and argument by its representatives was heard by the Committee on April —, 1922. It is contended by the appellant that the purpose and intent of section 208 of the Act of October 3, 1917, and section 331 of the Act of February 24, 1919, were to prohibit the inflation of the invested capital of a corporation through a voluntary reorganization, and that these sections should not apply to a case like the present, in which the reorganization or change of ownership was wholly involuntary and due solely to the expiration of the charter of the original corporation. It was admitted by the representatives of the appellant at the oral hearing that the assets of the original corporation were never actually distributed to the stockholders but were transferred directly by deed of the original corporation to the new corporation.

**Section 208 of the Act of October 3, 1917, provides:**

That in the case of the reorganization, consolidation, or change of ownership of a trade or business after March 3, 1917, if an interest or control in such trade or business of 50 per centum or more remains in control of the same persons, corporations, associations, partnerships, or any of them, then in ascertaining the invested capital of the trade or business no asset transferred or received from the prior trade or business shall be allowed a greater value than would have been allowed under this title in computing the invested capital of such prior trade or business if such asset had not been so transferred or received, unless such asset was paid for specifically as such, in case of tangible property, and then not to exceed the actual cash or actual cash value of the tangible property paid therefor at the time of such payment.

The same provision, with certain modifications which are not here material, was enacted as section 331 of the Act of February 24, 1919.

**Section 6699 of the State of Y Laws provides that:**

All corporations that expire by limitation specified in their articles of incorporation, \* \* \* continue to exist as bodies corporate for a period of five years thereafter, if necessary for the purpose of prosecuting or defending actions, suits, or proceedings by or against them, settling their business, disposing of their property, and dividing their capital stock, but not for the purpose of continuing their corporate business.

**Supplementary Bulletin Rulings.**

An examination of section 6705 of the State of Y Laws leads the Committee to concur in the opinion of the corporation commissioner of the State of Y that the existence of the original corporation could not have been continued by the filing of supplemental articles of incorporation, and that, therefore, the M Company constituted a new and separate corporation, but under the provisions of section 6699 the assets of the original corporation did not upon the expiration of its charter automatically revert to the stockholders, but the corporation continued for the purpose of winding up its affairs, and in accordance with the powers thus continued to it, its assets were conveyed to the new corporation.

Without attempting to characterize the proceedings in this case, it is clear that there was a change of ownership of a trade or business" or "a change of ownership of property," occurring after March 3, 1917, and not only 50 per centum but 100 per centum of the interest or control remained in the same persons. This case, therefore, clearly falls within the language of both sections 208 of the Act of October 3, 1917, and section 331 of the Act of February 24, 1919, and it does not appear to the Committee that it is outside the purpose and intent of those sections. The sections of the statutes themselves contain no exception in the case of an involuntary change of ownership and it seems clear the intent of Congress was to prevent the increase of the invested capital of a corporation by including therein appreciation in the value of its assets upon a change of ownership which was nominal and not substantial.

The Committee, therefore, finds that the appeal in this case is without merit and accordingly recommends that the action of the Income Tax Unit in requiring the M Company to file amended returns for the taxable years affected, pursuant to Treasury Decision 3220, be sustained.

17

(See A. R. M. 192; sec. 326, art. 836-27-17, herein.) Property acquired at receiver's sale by creditors or stockholders of old or new corporation or both subsequent to March 3, 1917.

18

II-('23)-35-1228: A. R. R. 3702.

#### Revenue Act of 1918.

A did not hold an interest or control of 50 per cent or more of a predecessor company except perhaps momentarily and as a mere incident or step in a reorganization. A held but an interest or control of approximately 36 per cent in the old company and he held an interest or control of approximately 80 per cent in the new company. Under the circumstances the provisions of section 331 are not applicable in computing the invested capital of the new corporation.

The Committee has carefully considered the appeal of the M Company from the action of the Income Tax Unit in holding that the provisions of section 331 of the Revenue Act of 1918 are applicable in computing its invested capital for the 10-month period ended August —, 1920, and in accordance with that holding reducing its invested capital, as reported for that period, by the amount of 331.3x dollars.

On various dates prior to October —, 1919, A, then the owner of approximately 36 per cent of the total outstanding preferred and common stock of the M Company, secured from the other stockholders an option to purchase all of their holdings in that company. A's purpose in securing such



options was to reorganize the company under the laws of the State of Z and to secure control of the new company. Upon the securing of these options by A on all the remaining shares of stock outstanding, the owners of these shares turned them over to a trustee to be held in their interest until the sale thereof was consummated. A at the time of securing these options did not have sufficient personal funds wherewith to exercise these options. He purposed to close the options by purchasing this stock with funds obtained through the sale of securities of the new company. Accordingly, on September —, 1919, A entered into an agreement with the N Company, bankers, wherein it was provided, among other things, that A should, at his own expense, cause the M Company to be reorganized in such a way that either said company or a new company to be organized should have outstanding at the conclusion of the reorganization the following: 300x dollars par value 7 per cent bonds, 7y shares (par value \$——) of 8 per cent cumulative preferred stock, and 20y shares of the par value of \$—— each, or without par value as the bankers might elect, of common stock. No par value shares of common were eventually issued. A agreed to sell and the bankers agreed to purchase outright all of the 300x dollars par value of bonds, the said 7y shares of preferred stock, and 6y shares of common stock for 436x dollars in cash, delivery of said securities and payment therefor to be made at the office of the bankers on November —, 1919.

On October —, 1919, the M Company, a State of Z corporation, was organized, and on the same date its board of directors, at their first meeting, voted to purchase the assets and business of the old corporation and in consideration of such acquisition authorized its officers to execute and deliver an instrument assuming each and all of the debts, liabilities, contracts, obligations, and undertakings of every kind and character of the old company, and in addition thereto to issue to the stockholders of the old company 300x dollars par value of the first mortgage 7 per cent serial gold bonds, 7y shares of 8 per cent cumulative preferred stock, and 20y shares of common stock without par value.

On November —, 1919, the stockholders of the old company voted to sell the business and assets of the company to the company of the State of Z for and in consideration of the purchase price stated in the preceding paragraph. On the same date the old company executed a deed conveying all its business and assets to the new company. Simultaneously with the execution of the deed the following acts were performed by the parties interested in the reorganization:

(a) The State of Z company issued to A the entire issue of 300x dollars par value of bonds, 7y shares of the par value of \$—— each of preferred stock, and 20y shares of no par value common stock.

(b) A assigned all of the securities of the State of Z company issued to him, except 14y shares of no par value common stock, to the N Company, and received in payment thereof 436x dollars in cash.

(c) The total cash received by A, 436x dollars, and 7y shares of the O Company were paid over to the other stockholders of the old company, thus closing the options to purchase their holdings in the latter company. All stock certificates were surrendered to the old company and a single certificate for the entire authorized issue of capital stock of the old company, except directors' qualifying shares, was issued to A. It was following the issue of this certificate that the meeting of the stockholders of the old company took place, at which the sale of the company's assets was authorized and the minutes of which meeting show that A was present as the owner of all the outstanding stock except qualifying shares, to which fact the Unit

draws attention as evidence that A held an interest and control of more than 50 per cent in the old company prior to the reorganization.

After a thorough consideration of all the foregoing facts, the Committee finds that A did not hold an interest or control of 50 per cent or more in the predecessor company, except perhaps momentarily and as a mere incident or step in the reorganization. It was stated by appellant company's representatives at the hearing that the thing which led up to the reorganization was the inability of A and his father, who virtually exercised a control of the corporation through his (the father's) wife's holding of more than 50 per cent of the common stock, to agree on questions of business policy necessitating the retirement of one of them from the company. As A's father virtually owned the O Company, he chose to devote his future endeavor to that company, leaving the future of the M Company in the hands of his son. It was because of A's father's action that the son was required to give up his holdings in the O Company in part payment of his mother's holdings in the M Company. Looking at the transaction after the whole reorganization scheme had been accomplished, the Committee finds that whereas A held but an interest or control of approximately 36 per cent in the old company, he held an interest or control of approximately 80 per cent in the Z State corporation. Under the circumstances, the Committee is constrained to hold that the provisions of section 331 of the Revenue Act of 1918 are not applicable in computing the invested capital of appellant company.

Accordingly, it is recommended that the action of the Income Tax Unit in holding that the provisions of section 331 of the Revenue Act of 1918 are applicable in computing the invested capital of appellant company be reversed, and the appeal in that respect be sustained.

KINGMAN BREWSTER, <sup>US TO 7</sup>

*Chairman, Committee on Appeals and Review.*

19



**Law Section 335.—Fiscal Years Ending in 1918 or 1919 (1918 Act—¶580, ante): Ending in 1921 or 1922 (1921 Act—¶1054, post).**

**Article 952.—Fiscal Year of Corporation Ending in 1918 (Reg. 45—¶843, ante): Ending in 1921 (Reg. 62—¶1250, post).**

(See 6-19-285; Section 328, Article 912.) Application of section 210 of the Revenue Act of 1917 and sections 327 and 328 of the Revenue Act of 1918 to fiscal year returns.





**Law Section 337.—Sale of Mineral Deposits (1918 Act—¶586, ante): (1921 Act—¶1057, post).**

**Article 971.—Tax on Sale of Mineral Deposits (Reg. 45—¶853, ante): (Reg. 62—¶1260, post).**

5-20-723: O. D. 395.

The fact that a company is entitled to the benefit of section 337 will not disqualify it for special treatment under section 328, neither can the fact that it is entitled to the benefit of section 337 be used as a basis for claiming special treatment under section 328. If a corporation falls within the class specified in section 327, the tax will be determined under the provisions of section 328. The effect of section 337 is to limit the amount of tax attributable to the profit made on the sale of mines, oil and gas wells discovered by the taxpayer and can only be applied after the tax computed on such profit has been computed without the benefit of this section.

1

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37-20-1190: O. D. 658.

The limitation provided in section 211 (b) of the Revenue Act of 1918, with respect to the tax attributable to the sale of mines, oil or gas wells, of any interest therein has no application to the tax on profits realized from the sale of oil and gas produced in the operation of such wells.

2





Supplementary. Rulings Reprinted from the Internal Revenue Bulletins.

01. The Foreword to the Supplementary Rulings should be read.

**Caution.**—To the extent of the imposition of the excess-profits tax for 1921, the 1918 and 1921 laws are identical, except that domestic corporations entitled to the benefits of Section 262 of the 1921 Act (§1083) are grouped with foreign corporations for the purposes of the 1921 excess-profits tax. To much the same extent, with like qualifications, the provisions of Regulations 62 (1921 Act) are essentially identical (there are frequent verbal changes) to the provisions of Regulations 45 (1918 Act). The numbering of the Articles of Regulations 62 (1921 Act) is the same as that of the respective corresponding Articles of Regulations 45 (1918 Act), except as noted below. It follows then, that, except as noted below, for the purposes of the Supplementary Bulletin Rulings, the Article reference number is the same under either Act.

	Reg. 62 (1921 Act)	Reg. 45 (1918 Act)
3307	No corresponding Article.....	to Article 712
3307	Article 712 is the same as, therefore refer to, Article	713
3307	" " 713 " " " "	" " " " 714
3307	" " 714 " " " "	(648 206) " " " " 715
3307	" " 715 " " " "	" " " " 716
3307	No corresponding Article.....	to Article 717
3307	Article 716 is the same as, therefore refer to, Article	719
3307	" " 717 " " " "	3307 " " " " 718
3307	" " 718 " " " "	" " " " " " 720
3307	No corresponding Article.....	to Article 869
3307	Article 869 is the same as, therefore refer to, Article	870
3307	" " 870 " " " "	" " " " " " 871

Art. of Reg. 62 is same as, therefore refer to, same numbered Art. of Reg. 45

(The list is always up-to-date.)

Law Section	Article Number	Last Ruling	Law Section	Article Number	Last Ruling
300	701	None	302	732	1
301	711	1	"	733	None
"	712	None	303	741	2
"	713	None	"	742	None
"	714	11	"	743	None
"	715	2	304	751	None
"	716	None	"	752	1
"	717	None	"	753	None
"	718	None	305	761	None
"	719	1	310	771	1
"	720	None	311	781	3
302	731	1	"	782	None

**Insert immediately preceding blue page 401.**

(Over.)

Law Section	Article Number	Last Ruling	Law Section	Article Number	Last Ruling
311.....	783.....	1	326.....	854.....	2
"	784.....	None	"	855.....	1
"	785.....	None	"	856.....	None
312.....	791.....	4	"	857.....	7
320.....	801.....	1	"	858.....	10
"	802.....	1	"	859.....	2
325.....	811.....	2	"	860.....	1
"	812.....	3	"	861.....	None
"	813.....	10	"	862.....	4
"	814.....	None	"	863.....	None
"	815.....	9	"	864.....	None
"	816.....	1	"	865.....	None
"	817.....	1	"	866.....	None
"	818.....	3	"	867.....	None
326.....	831.....	45	"	868.....	None
"	832.....	None	"	869.....	1
"	833.....	6	"	870.....	1
"	834.....	1	"	871.....	1
"	835.....	4	327.....	901.....	31
"	836.....	19	328.....	911.....	2
"	837.....	7	"	912.....	3
"	838.....	10	"	913.....	1
"	839.....	4	"	914.....	2
"	840.....	10	330.....	931.....	4
"	841.....	5	"	932.....	1
"	842.....	None	"	933.....	8
"	843.....	2	"	934.....	None
"	844.....	2	331.....	941.....	19
"	845.....	11	335.....	951.....	None
"	845A.....	(See 845)	"	952.....	1
"	846.....	4	"	953.....	None
"	847.....	None	"	954.....	None
"	848.....	None	"	955.....	None
"	849.....	None	336.....	961.....	None
"	850.....	2	"	962.....	None
"	851.....	7	337.....	971.....	2
"	852.....	2	"	972.....	None
"	853.....	1	338.....	981.....	None

Every Article of Regulations 45 (1918 Act) and of Regulations 62 (1921 Act) bearing specifically on the war-profits and excess-profits tax is listed in the foregoing table. The first Article is 701.

Missing Article numbers such as 702 to 710 have not yet been used.

*The last Bulletin from which rulings have  
been reproduced hereinbefore and as listed above is*

VOLUME II (1923), No. 39.

*Later Bulletins, since issued (if any), contain no rulings bearing on the  
1918 or 1921 excess-profits tax laws.*

Insert this page to face blue page 401.



# WAR-PROFITS AND EXCESS-PROFITS TAX FOR 1921.

BEING TITLE III OF THE REVENUE ACT OF 1921.

*(Expires by limitation December 31, 1921.)*

The War-Profits and Excess-Profits Tax Title (III) of the Revenue Act of 1918 is reproduced, followed by the Regulations bearing thereon, beginning on page 301.

## CALENDAR.

(Same as for Income Tax.)

**Return:** Domestic corporation, and foreign corporation other than one not having any office or place of business in the United States:

Calendar year basis, on or before March 15.

Fiscal year basis, on or before the fifteenth day of the third month after the close of the taxable year.

**Return:** Foreign corporation not having any office or place of business in the United States.

Calendar year basis, on or before June 15.

Fiscal year basis, on or before the fifteenth day of the sixth month after the close of the taxable year.

**Tax:** (a) All on or before due date for filing return, or

(b) In four equal installments: first installment on or before due date for filing return; subsequent installments at three-month intervals.

If any installment is not paid on or before the due date, all of the unpaid balance of the tax becomes due and payable on notice and demand.

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[The captions and other matters in [brackets] are ours.]

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## TITLE III.—WAR-PROFITS AND EXCESS-PROFITS TAX FOR 1921.

*[Expires by limitation December 31, 1921.]*

### PART I.—GENERAL DEFINITIONS.

**1000 Sec. 300.** That when used in this title the terms "taxable year," "fiscal year," "personal service corporation," "paid or accrued," and "dividends" shall have the same meaning as provided for the purposes of income tax in sections 200 and 201.

[Definitions of terms, extracted from Sections 2, 200, and 201 of the Revenue Act of 1921.]

### ["Taxable year" and "Fiscal year."]

**1001 (1)** The term "taxable year" means the calendar year, or the fiscal year ending during such calendar year, upon the basis of which the net income is computed under section 212 or section 232. The term "fiscal year" means an accounting period of twelve months ending on the last day of any month other than December. The first taxable year, to be called the taxable year 1921, shall be the calendar year 1921 or any fiscal year ending during the calendar year 1921.

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## [“Personal Service Corporation.”]

**1002** (5) The term “personal service corporation” means a corporation whose income is to be ascribed primarily to the activities of the principal owners or stockholders who are themselves regularly engaged in the active conduct of the affairs of the corporation and in which capital (whether invested or borrowed) is not a material income-producing factor; but does not include any foreign corporation, nor any corporation 50 per centum or more of whose gross income consists either (1) of gains, profits, or income derived from trading as a principal, or (2) of gains, profits, commissions, or other income, derived from a government contract or contracts made between April 6, 1917, and November 11, 1918, both dates inclusive.

## [“Government Contracts.”]

**1003** (11) The term “government contract” means (a) a contract made with the United States, or with any department, bureau, officer, commission, board, or agency, under the United States and acting in its behalf, or with any agency controlled by any of the above if the contract is for the benefit of the United States, or (b) a subcontract made with a contractor performing such a contract if the products or services to be furnished under the subcontract are for the benefit of the United States. The term “government contract or contracts made between April 6, 1917, and November 11, 1918, both dates inclusive” when applied to a contract of the kind referred to in clause (a) of this subdivision, includes all such contracts which, although entered into during such period, were originally not enforceable, but which have been or may become enforceable by reason of subsequent validation in pursuance of law.

## [“Paid or incurred” and “Paid or accrued.”]

**1004** (4) The term “paid,” for the purposes of the deductions and credits under this title, means “paid or accrued” or “paid or incurred,” and the terms “paid or incurred” and “paid or accrued” shall be construed according to the method of accounting upon the basis of which the net income is computed under section 212.

## [“Dividends.”]

**1005** Sec. 201 [of the Revenue Act of 1921]. (a) That the term “dividend” when used in this title (except in paragraph (10) of subdivision (a) of section 234 and paragraph (4) of subdivision (a) of section 245) means any distribution made by a corporation to its shareholders or members, whether in cash or in other property, out of its earnings or profits accumulated since February 28, 1913, except a distribution made by a personal service corporation out of earnings or profits accumulated since December 31, 1917, and prior to January 1, 1922.

**1006** (b) For the purposes of this Act every distribution is made out of earnings or profits, and from the most recently accumulated earnings or profits, to the extent of such earnings or profits accumulated since February 28, 1913; but any earnings or profits accumulated or increase in value of property accrued prior to March 1, 1913, may be distributed exempt from the



tax, after the earnings and profits accumulated since February 28, 1913, have been distributed. If any such tax-free distribution has been made the distributee shall not be allowed as a deduction from gross income any loss sustained from the sale or other disposition of his stock or shares unless, and then only to the extent that, the basis provided in section 202 exceeds the sum of (1) the amount realized from the sale or other disposition of such stock or shares, and (2) the aggregate amount of such distributions received by him thereon.

**1007** (c) Any distribution (whether in cash or other property) made by a corporation to its shareholders or members otherwise than out of (1) earnings or profits accumulated since February 28, 1913, or (2) earnings or profits accumulated or increase in value of property accrued prior to March 1, 1913, shall be applied against and reduce the basis provided in section 202 for the purpose of ascertaining the gain derived or the loss sustained from the sale or other disposition of the stock or shares by the distributee.

**1008** (d) A stock dividend shall not be subject to tax but if after the distribution of any such dividend the corporation proceeds to cancel or redeem its stock at such time and in such manner as to make the distribution and cancellation or redemption essentially equivalent to the distribution of a taxable dividend, the amount received in redemption or cancellation of the stock shall be treated as a taxable dividend to the extent of the earnings or profits accumulated by such corporation after February 28, 1913.

**1009** (e) For the purposes of this Act, a taxable distribution made by a corporation to its shareholders or members shall be included in the gross income of the distributees as of the date when the cash or other property is unqualifiedly made subject to their demands.

**1010** (f) Any distribution made during the first sixty days of any taxable year shall be deemed to have been made from earnings or profits accumulated during preceding taxable years; but any distribution made during the remainder of the taxable year shall be deemed to have been made from earnings or profits accumulated between the close of the preceding taxable year and the date of distribution, to the extent of such earnings or profits, and if the books of the corporation do not show the amount of such earnings or profits, the earnings or profits for the accounting period within which the distribution was made shall be deemed to have been accumulated ratably during such period. This subdivision shall not be in effect after December 31, 1921.

## PART II.—IMPOSITION OF TAX.

**1011** Sec. 301. (a) That in lieu of the tax imposed by Title III\* of the Revenue Act of 1918, but in addition to the other taxes imposed by this Act, there shall be levied, collected and paid for the calendar year 1921 upon the net income of every corporation (except corporations taxable under subdivision (b) of this section) a tax equal to the sum of the following:

### First Bracket.

**1012** 20 per centum of the amount of the net income in excess of the excess-profits credit (determined under section 312) and not in excess of 20 per centum of the invested capital;

**Second Bracket.**

**1013** 40 per centum of the amount of the net income in excess of 20 per centum of the invested capital.

**1014** (b) For the calendar year 1921 there shall be levied, collected, and paid upon the net income of every corporation which derives in such year a net income of more than \$10,000 from any Government contract or contracts made between April 6, 1917, and November 11, 1918, both dates inclusive, a tax equal to the sum of the following:

**1015** (1) Such a portion of a tax computed at the rates specified in subdivision (a) of section 301 of the Revenue Act of 1918\*, as the part of the net income attributable to such Government contract or contracts bears to the entire net income. In computing such tax the excess-profits credit and the war-profits credit which would be applicable to such calendar year under the Revenue Act of 1918\* if it had been continued in force, shall be used;

**1016** (2) Such a portion of a tax computed at the rates specified in subdivision (a) of this section as the part of the net income not attributable to such Government contract or contracts bears to the entire net income.

**1017** For the purpose of determining the part of the net income attributable to such Government contract or contracts, the proper apportionment and allocation of the deductions with respect to gross income derived from such Government contract or contracts and from other sources, respectively, shall be determined under rules and regulations prescribed by the Commissioner with the approval of the Secretary.

**1018** (c) In any case where the full amount of the excess-profits credit is not allowed under the first bracket of subdivision (a), by reason of the fact that such credit is in excess of 20 per centum of the invested capital, the part not so allowed shall be deducted from the amount in the second bracket.

**[Maximum Tax Limitation.]**

**1019 Sec. 302.** That the tax imposed by subdivision (a) of section 301 shall in no case be more than 20 per centum of the amount of the net income in excess of \$3,000 and not in excess of \$20,000, plus 40 per centum of the amount of the net income in excess of \$20,000; and the limitations imposed by section 302 of the Revenue Act of 1918\* (upon taxes computed under subdivision (c) of section 301 of that Act) are hereby made applicable to taxes computed under subdivision (b) of section 301 of this Act. Nothing in this section shall be construed in such manner as to increase the tax imposed by section 301 of this Act.

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\*The War-Profits and Excess-Profits Tax Title (III) of the Revenue Act of 1918 is reproduced, followed by the regulations bearing thereon, beginning on page 301.



## [Partial Personal Service Corporations.]

**1020 Sec. 303.** That if part of the net income of a corporation is derived (1) from a trade or business (or a branch of a trade or business) in which the employment of capital is necessary, and (2) a part (constituting not less than 30 per centum of its total net income) is derived from a separate trade or business (or a distinctly separate branch of the trade or business) which if constituting the sole trade or business would bring it within the class of "personal service corporations," then (under regulations prescribed by the Commissioner with the approval of the Secretary) the tax upon the first part of such net income shall be separately computed (allowing in such computation only the same proportionate part of the credits authorized in section 312), and the tax upon the second part shall be the same percentage thereof as the tax so computed upon the first part is of such first part: *Provided*, That the tax upon such second part shall in no case be less than 20 per centum thereof, unless the tax upon the entire net income, if computed without benefit of this section, would constitute less than 20 per centum of such entire net income, in which event the tax shall be determined upon the entire net income, without reference to this section, as other taxes are determined under this title. The total tax computed under this section shall be subject to the limitations provided in section 302.

## [Exempt Corporations.]

**1021 Sec. 304.** (a) That the corporations enumerated in section 231 [¶1059] shall, to the extent that they are exempt from income tax under Title II, be exempt from taxation under this title.

**1022** (b) Any corporation whose net income for the taxable year is less than \$3,000 shall be exempt from taxation under this title.

**1023** (c) In the case of any corporation engaged in the mining of gold, the portion of the net income derived from the mining of gold shall be exempt from the tax imposed by this title or any tax imposed by Title II of the Revenue Act of 1917, and the tax on the remaining portion of the net income shall be the same proportion of a tax computed without the benefit of this subdivision which such remaining portion of the net income bears to the entire net income.

## [Specific Exemption in Relation to Tax for less than 12 months.]

**1024 Sec. 305.** That if a tax is computed under this title for a period of less than twelve months, the specific exemption of \$3,000, wherever referred to in this title, shall be reduced to an amount which is the same proportion of \$3,000 as the number of months in the period is of twelve months.

## Part III.—Excess-Profits Credit.

**1025 Sec. 312.** That the excess-profits credit shall consist of a specific exemption of \$3,000 plus an amount equal to 8 per centum of the invested capital for the taxable year.

**1026** A foreign corporation or a corporation entitled to the benefits of section 262 [¶1083] shall not be entitled to the specific exemption of \$3,000.

#### Part IV.—Net Income.

**1027** Sec. 320. That for the purpose of this title the net income of a corporation shall be ascertained and returned for the taxable year upon the same basis and in the same manner as provided for income tax purposes in Title II of this Act.

#### Part V.—Invested Capital.

**1028** Sec. 325. (a) That as used in this title—

**1029** The term “intangible property” means patents, copyrights, secret processes and formulae, good will, trade-marks, trade-brands, franchises, and other like property;

**1030** The term “tangible property” means stocks, bonds, notes, and other evidences of indebtedness, bills and accounts receivable, leaseholds, and other property other than intangible property;

**1031** The term “borrowed capital” means money or other property borrowed, whether represented by bonds, notes, open accounts, or otherwise;

**1032** The term “inadmissible assets” means stocks, bonds, and other obligations (other than obligations of the United States), the dividends or interest from which is not included in computing net income, but where the income derived from such assets consists in part of gain or profit derived from the sale or other disposition thereof, or where all or part of the interest derived from such assets is in effect included in the net income because of the limitation on the deduction of interest under paragraph (2) of subdivision (a) of section 234, a corresponding part of the capital invested in such assets shall not be deemed to be inadmissible assets;

**1033** The term “admissible assets” means all assets other than inadmissible assets, valued in accordance with the provisions of subdivision (a) of section 326 and section 331.

**1034** (b) For the purposes of this title the par value of stock or shares shall, in the case of stock or shares issued at a nominal value or having no par value, be deemed to be the fair market value as of the date or dates of issue of such stock or shares.

#### [Computing “Invested Capital.”]

**1035** Sec. 326. (a) That as used in this title the term “invested capital” for any year means (except as provided in subdivisions (b) and (c) of this section):

**1036** (1) Actual cash bona fide paid in for stock or shares;

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**1037** (2) Actual cash value of tangible property, other than cash, bona fide paid in for stock or shares, at the time of such payment, but in no case to exceed the par value of the original stock or shares specifically issued therefor, unless the actual cash value of such tangible property at the time paid in is shown to the satisfaction of the Commissioner to have been clearly and substantially in excess of such par value, in which case such excess shall be treated as paid-in surplus: *Provided*, That the Commissioner shall keep a record of all cases in which tangible property is included in invested capital at a value in excess of the stock or shares issued therefor, containing the name and address of each taxpayer, the business in which engaged, the amount of invested capital and net income shown by the return, the value of the tangible property at the time paid in, the par value of the stock or shares specifically issued therefor, and the amount included under this paragraph as paid-in surplus. The Commissioner shall furnish a copy of such record and other detailed information with respect to such cases when required by resolution of either House of Congress, without regard to the restrictions contained in section 257;

**1038** (3) Paid-in or earned surplus and undivided profits; not including surplus and undivided profits earned during the year;

**1039** (4) Intangible property bona fide paid in for stock or shares prior to March 3, 1917, in an amount not exceeding (a) the actual cash value of such property at the time paid in, (b) the par value of the stock or shares issued therefor, or (c) in the aggregate 25 per centum of the par value of the total stock or shares of the corporation outstanding on March 3, 1917, whichever is lowest;

**1040** (5) Intangible property bona fide paid in for stock or shares on or after March 3, 1917, in an amount not exceeding (a) the actual cash value of such property at the time paid in, (b) the par value of the stock or shares issued therefor, or (c) in the aggregate 25 per centum of the par value of the total stock or shares of the corporation outstanding at the beginning of the taxable year, whichever is lowest: *Provided*, That in no case shall the total amount included under paragraphs (4) and (5) exceed in the aggregate 25 per centum of the par value of the total stock or shares of the corporation outstanding at the beginning of the taxable year; but

**1041** (b) As used in this title the term "invested capital" does not include borrowed capital.

**1042** (c) There shall be deducted from invested capital as above defined a percentage thereof equal to the percentage which the amount of inadmissible assets is of the amount of admissible and inadmissible assets held during the taxable year.

**1043** (d) The invested capital for any period shall be the average invested capital for such period, but in the case of a corporation making a return for a fractional part of a year, it shall be the same fractional part of such average invested capital.

## [Special Cases Subject to Special Tax.]

- 1044 Sec. 327.** That in the following cases the tax shall be determined as provided in section 328:
- 1045** (a) Where the Commissioner is unable to determine the invested capital as provided in section 326;
- 1046** (b) In the case of a foreign corporation or of a corporation entitled to the benefits of section 262 [¶1083];
- 1047** (c) Where a mixed aggregate of tangible property and intangible property has been paid in for stock or for stock and bonds and the Commissioner is unable satisfactorily to determine the respective values of the several classes of property at the time of payment, or to distinguish the classes of property paid in for stock and for bonds, respectively;
- 1048** (d) Where upon application by the corporation the Commissioner finds and so declares of record that the tax if determined without benefit of this section would, owing to abnormal conditions affecting the capital or income of the corporation, work upon the corporation an exceptional hardship evidenced by gross disproportion between the tax computed without benefit of this section and the tax computed by reference to the representative corporations specified in section 328. This subdivision shall not apply to any case (1) in which the tax (computed without benefit of this section) is high merely because the corporation earned within the taxable year a high rate of profit upon a normal invested capital, nor (2) in which 50 per centum or more of the gross income of the corporation for the taxable year (computed under section 233 of Title II) consists of gains, profits, commissions, or other income, derived on a cost-plus basis from a Government contract or contracts made between April 6, 1917, and November 11, 1918, both dates inclusive.

## [The Special Tax Applicable to the Special Cases.]

- 1049 Sec. 328.** (a) That in the cases specified in section 327 the tax shall be the amount which bears the same ratio to the net income of the taxpayer (in excess of the specific exemption of \$3,000) for the taxable year, as the average tax of representative corporations engaged in a like or similar trade or business, bears to their average net income (in excess of the specific exemption of \$3,000) for such year. In the case of a foreign corporation or of a corporation entitled to the benefits of section 262 [¶1083] the tax shall be computed without deducting the specific exemption of \$3,000 either for the taxpayer or the representative corporations
- 1050** In computing the tax under this section the Commissioner shall compare the taxpayer only with representative corporations whose invested capital can be satisfactorily determined under section 326 and which are, as nearly as may be, similarly circumstanced with respect to gross income, net income, profits per unit of business transacted and capital employed, the amount and rate of war profits or excess profits, and all other relevant facts and circumstances.



**1051** (b) For the purposes of subdivision (a) the ratios between the average tax and the average net income of representative corporations shall be determined by the Commissioner in accordance with regulations prescribed by him with the approval of the Secretary.

**1052** (c) The Commissioner shall keep a record of all cases in which the tax is determined in the manner prescribed in subdivision (a), containing the name and address of each taxpayer, the business in which engaged, the amount of invested capital and net income shown by the return, and the amount of invested capital as determined under such subdivision. The Commissioner shall furnish a copy of such record and other detailed information with respect to such cases when required by resolution of either House of Congress, without regard to the restrictions contained in section 257.

### Part VI.—Reorganizations.

**1053** **Sec. 331.** That in the case of the reorganization, consolidation, or change of ownership of a trade or business, or change of ownership of property, after March 3, 1917, if an interest or control in such trade or business or property of 50 per centum or more remains in the same persons, or any of them, then no asset transferred or received from the previous owner shall, for the purpose of determining invested capital, be allowed a greater value than would have been allowed under this title in computing the invested capital of such previous owner if such asset had not been so transferred or received: *Provided*, That if such previous owner was not a corporation, then the value of any asset so transferred or received shall be taken at its cost of acquisition (at the date when acquired by such previous owner) with proper allowance for depreciation, impairment, betterment or development, but no addition to the original cost shall be made for any charge or expenditure deducted as expense or otherwise on or after March 1, 1913, in computing the net income of such previous owner for purposes of taxation.

### Part VII.—Miscellaneous.

#### [Returns on Fiscal Year Basis.]

**1054** **Sec. 335.** (a) That if a corporation (other than a personal service corporation) makes return for a fiscal year beginning in 1920 and ending in 1921, the war-profits and excess-profits tax for the taxable year 1921 shall be the sum of: (1) the same proportion of a tax for the entire period computed under the Revenue Act of 1918,\* which the portion of such period falling within the calendar year 1920 is of the entire period, and (2) the same proportion of a tax for the entire period computed under this title, which the portion of such period falling within the calendar year 1921 is of the entire period. Any amount heretofore or hereafter paid on account of the tax imposed for such taxable year by the Revenue Act of 1918 shall be credited towards the payment of the tax as above computed, and if the amount so paid exceeds the amount of such tax, the excess shall be credited or refunded to the corporation in accordance with the provisions of section 252 of this Act.

\*The War-Profits and Excess-Profits Tax Title (III) of the Revenue Act of 1918, reproduced, followed by the regulations bearing thereon, beginning on page 301.

**1055** (b) If a corporation (other than a personal service corporation) makes a return for a fiscal year beginning in 1921 and ending in 1922, the war-profits and excess-profits tax for the portion of the year falling within the calendar year 1921 shall be an amount equivalent to the same proportion of a tax for the entire period computed under this title, which the portion of such period falling within the calendar year 1921 is of the entire period.

**[Returns and Payment of Taxes.]**

**1056 Sec. 336.** That every corporation, not exempt under section 304, shall make a return for the purposes of this title. Such returns shall be made, and the taxes imposed by this title shall be paid, at the same times and places, in the same manner, and subject to the same conditions, as is provided in the case of returns and payment of income tax by corporations for the purposes of Title II, and all the provisions of that title not inapplicable, including penalties, are hereby made applicable to the taxes imposed by this title.

**[Sale of Mines, Oil or Gas Wells.]**

**1057 Sec. 337.** That in the case of a bona fide sale of mines, oil or gas wells, or any interest therein, where the principal value of the property has been demonstrated by prospecting or exploration and discovery work done by the taxpayer, the portion of the tax imposed by this title attributable to such sale shall not exceed 20 per centum of the selling price of such property or interest.

**Effective Date of Title.**

**1058 Sec. 338.** That this title shall take effect as of January 1, 1921.

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**Conditional and Other Exemptions of Corporations.**

**1059 Sec. 231** [of the Revenue Act of 1921]. That the following organizations shall be exempt from taxation under this title—

**1060** (1) Labor, agricultural, or horticultural organizations;

**1061** (2) Mutual savings banks not having a capital stock represented by shares;

**1062** (3) Fraternal beneficiary societies, orders, or associations, (a) operating under the lodge system or for the exclusive benefit of the members of a fraternity itself operating under the lodge system; and (b) providing for the payment of life, sick, accident, or other benefits to the members of such society, order, or association or their dependents;

**1063** (4) Domestic building and loan associations substantially all the business of which is confined to making loans to members; and co-operative banks without capital stock organized and operated for mutual purposes and without profit;



**1064** (5) Cemetery companies owned and operated exclusively for the benefit of their members or which are not operated for profit; and any corporation chartered solely for burial purposes as a cemetery corporation and not permitted by its charter to engage in any business not necessarily incident to that purpose, no part of the net earnings of which inures to the benefit of any private stockholder or individual;

**1065** (6) Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private stockholder or individual;

**1066** (7) Business leagues, chambers of commerce, or boards of trade, not organized for profit and no part of the net earnings of which inures to the benefit of any private stockholder or individual;

**1067** (8) Civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare;

**1068** (9) Clubs organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes, no part of the net earnings of which inures to the benefit of any private stockholder or member;

**1069** (10) Farmers' or other mutual hail, cyclone, or fire insurance companies, mutual ditch or irrigation companies, mutual or cooperative telephone companies, or like organizations of a purely local character, the income of which consists solely of assessments, dues, and fees collected from members for the sole purpose of meeting expenses;

**1070** (11) Farmers', fruit growers', or like associations, organized and operated as sales agents for the purpose of marketing the products of members and turning back to them the proceeds of sales, less the necessary selling expenses, on the basis of the quantity of produce furnished by them; or organized and operated as purchasing agents for the purpose of purchasing supplies and equipment for the use of members and turning over such supplies and equipment to such members at actual cost, plus necessary expenses;

**1071** (12) Corporations organized for the exclusive purpose of holding title to property, collecting income therefrom, and turning over the entire amount thereof, less expenses, to an organization which itself is exempt from the tax imposed by this title;

**1072** (13) Federal land banks and national farm-loan associations as provided in section 26 of the Act approved July 17, 1916, entitled "An Act to provide capital for agricultural development, to create standard forms of investment based upon farm mortgage, to equalize rates of interest upon farm loans, to furnish a market for United States bonds, to create Government depositaries and financial agents for the United States, and for other purposes";

**1073** (14) Personal service corporations. This subdivision shall not be in effect after December 31, 1921.

### Consolidated Returns of Corporations.

**1074** **Sec. 240** [of the Revenue Act of 1921]. (a) That corporations which are affiliated within the meaning of this section may, for any taxable year beginning on or after January 1, 1922 [see ¶1078 below], make separate returns or, under regulations prescribed by the Commissioner with the approval of the Secretary, make a consolidated return of net income for the purpose of this title, in which case the taxes thereunder shall be computed and determined upon the basis of such return. If return is made on either of such bases, all returns thereafter made shall be upon the same basis unless permission to change the basis is granted by the Commissioner.

**1075** (b) In any case in which a tax is assessed upon the basis of a consolidated return, the total tax shall be computed in the first instance as a unit and shall then be assessed upon the respective affiliated corporations in such proportions as may be agreed upon among them, or, in the absence of any such agreement, then on the basis of the net income properly assignable to each. There shall be allowed in computing the income tax only one specific credit computed as provided in subdivision (b) of section 236.

**1076** (c) For the purpose of this section two or more domestic corporations shall be deemed to be affiliated (1) if one corporation owns directly or controls through closely affiliated interests or by a nominee or nominees substantially all the stock of the other or others, or (2) if substantially all the stock of two or more corporations is owned or controlled by the same interests.

**1077** (d) For the purposes of this section a corporation entitled to the benefits of section 262 [¶1083] shall be treated as a foreign corporation: *Provided*, That in any case of two or more related trades or businesses (whether unincorporated or incorporated and whether organized in the United States or not) owned or controlled directly or indirectly by the same interests, the Commissioner may consolidate the accounts of such related trades and businesses, in any proper case, for the purpose of making an accurate distribution or apportionment of gains, profits, income, deductions, or capital between or among such related trades or businesses.

**1078** (e) Corporations which are affiliated within the meaning of this section shall make consolidated returns for any taxable year beginning prior to January 1, 1922, in the same manner and subject to the same conditions as provided by the Revenue Act of 1918 [for which see page 314].

### Consolidated Returns for Year 1917.

**1079** **Sec. 1331** [of the Revenue Act of 1921]. (a) That Title II of the Revenue Act of 1917 shall be construed to impose the taxes therein mentioned upon the basis of consolidated returns of net income and invested capital in the case of domestic corporations and domestic partnerships that were affiliated during the calendar year 1917.

**1080** (b) For the purpose of this section a corporation or partnership was affiliated with one or more corporations or partnerships (1) when such corporation or partnership owned directly or controlled through closely affiliated interests or by a nominee or nominees all or substantially all the



stock of the other or others, or (2) when substantially all the stock of two or more corporations or the business of two or more partnerships was owned by the same interests: *Provided*, That such corporations or partnerships were engaged in the same or a closely related business, or one corporation or partnership bought from or sold to another corporation or partnership products or services at prices above or below the current market, thus effecting an artificial distribution of profits, or one corporation or partnership in any way so arranged its financial relationships with another corporation or partnership as to assign to it a disproportionate share of net income or invested capital. For the purposes of this section, public service corporations which (1) were operated independently, (2) were not physically connected or merged, and (3) did not receive special permission to make a consolidated return, shall not be construed to have been affiliated; but a railroad or other public utility which was owned by an industrial corporation and was operated as a plant facility or as an integral part of a group organization of affiliated corporations which were required to file a consolidated return, shall be construed to have been affiliated.

**1081** (c) The provisions of this section are declaratory of the provisions of Title II of the Revenue Act of 1917.

#### **Incorporation of Individual or Partnership Business.**

**1082** **Sec. 229** [of the Revenue Act of 1921]. That in the case of the organization as a corporation within four months after the passage\* of this Act of any trade or business in which capital is a material income-producing factor, and which was previously owned by a partnership or individual, the net income of such trade or business from January 1, 1921, to the date of such organization may at the option of the individual or partnership be taxed as the net income of a corporation is taxed under Titles II and III; in which event the net income and invested capital of such trade or business shall be computed as if such corporation had been in existence on and after January 1, 1921, and the undistributed profits or earnings of such trade or business shall not be subject to the surtaxes imposed in section 211, but amounts distributed on and after January 1, 1921, from the earnings or profits of such trade or business accumulated after December 31, 1920, shall be taxed to the recipients as dividends; and all the provisions of Titles II and III relating to corporations shall so far as practicable apply to such trade or business: *Provided*, That this section shall not apply to any trade or business, the net income of which for the taxable year 1921 was less than 20 per centum of its invested capital for such year: *Provided further*, That any taxpayer who takes advantage of this section shall pay the tax imposed by section 1000 [Capital Stock Tax] of the Revenue Act of 1918 as if such taxpayer had been a corporation on and after January 1, 1921.

#### **Income From Sources Within the Possessions of the United States.**

**1083** **Sec. 262** [of the Revenue Act of 1921]. (a) That in the case of citizens of the United States or domestic corporations, satisfying the following conditions, gross income means only gross income from sources within the United States—

\*The date of passage of "this Act" is November 23, 1921.

**1084** (1) If 80 per centum or more of the gross income of such citizen or domestic corporation (computed without the benefit of this section) for the three-year period immediately preceding the close of the taxable year (or for such part of such period immediately preceding the close of such taxable year as may be applicable) was derived from sources within a possession of the United States; and

**1085** (2) If, in the case of such corporation, 50 per centum or more of its gross income (computed without the benefit of this section) for such period or such part thereof was derived from the active conduct of a trade or business within a possession of the United States; or

**1086** (3) If, in the case of such citizen, 50 per centum or more of his gross income (computed without the benefit of this section) for such period or such part thereof was derived from the active conduct of a trade or business within a possession of the United States either on his own account or as an employee or agent of another.

**1087** (b) Notwithstanding the provisions of subdivision (a) there shall be included in gross income all amounts received by such citizens or corporations within the United States, whether derived from sources within or without the United States.

**1088** (c) As used in this section the term "possession of the United States" does not include the Virgin Islands of the United States.

#### Consolidation of Liberty Bond Tax Exemptions.

**1089** **Sec. 1328** [of the Revenue Act of 1921]. That the various Acts authorizing the issues of Liberty bonds are amended and supplemented as follows:

**1090** (a) On and after January 1, 1921, 4 per centum and  $4\frac{1}{4}$  per centum Liberty bonds shall be exempt from graduated additional income taxes, commonly known as surtaxes, and excess-profits and war-profits taxes, now or hereafter imposed by the United States upon the income or profits of individuals, partnerships, corporations, or associations, in respect to the interest on aggregate principal amounts thereof as follows:

**1091** Until the expiration of two years after the date of the termination of the war between the United States and the German Government,\* as fixed by proclamation of the President, on \$125,000 aggregate principal amount; and for three years more on \$50,000 aggregate principal amount.

**1092** (b) The exemptions provided in subdivision (a) shall be in addition to the exemptions provided in section 7 of the Second Liberty Bond Act [¶728 II a], and in addition to the exemption provided in subdivision (3) of section 1 of the Supplement to the Second Liberty Bond Act in respect to bonds issued upon conversion of  $3\frac{1}{2}$  per centum bonds [¶728 II b], but shall be in lieu of the exemptions provided and free from the conditions and limitations imposed in subdivisions (1) and (2) of section 1 of the Supplement to Second

\*The date of the termination of the war is July 2, 1921.



Liberty Bond Act and in section 2 of the Victory Liberty Loan Act [¶728 II\_c, d, e, f].

### Alternative Tax on Personal Service Corporations.

**1093** Sec. 1332 [of the Revenue Act of 1921]. (a) That if either subdivision (e) of section 218 of the Revenue Act of 1918 or subdivision (d) of section 218 of this Act is by final adjudication declared invalid, there shall, in addition to all other taxes, be levied, collected, and paid on the net income (as defined in section 232) received during the calendar years 1918, 1919, 1920, and 1921, by every personal service corporation (as defined in section 200) included within the provisions of such subdivisions, a tax equal to the taxes imposed by Titles II and III of the Revenue Act of 1918 and, in the case of income received during the calendar year 1921, by Titles II and III of this Act.

**1094** (b) In such event every such personal service corporation shall, on or before the fifteenth day of the sixth month following the date of entry of decree upon such final adjudication, make a return of any income received during each of the calendar years 1918, 1919, 1920, and 1921 in the manner prescribed by the Revenue Act of 1918 (or in the manner prescribed by this Act, in the case of income received during the calendar year 1921). Such return shall be made and the net income shall be computed on the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in the manner provided for other corporations under the Revenue Act of 1918 and this Act.

**1095** (c) If either subdivision (e) of section 218 of the Revenue Act of 1918 or subdivision (d) of section 218 of this Act is so declared invalid, claims for credit or refund of taxes paid under both such sections shall be allowed, if made within the time provided in subdivision (f) of this section.

**1096** (d) In case the claims for credit or refund, filed within six months from such date of entry of decree, represent less than 30 per centum of the outstanding stock or shares in the corporation, the amount of taxes imposed by this section upon such corporation shall be reduced to that proportion thereof which the number of stock or shares owned by the shareholders or members making such claims bears to the total number of stock or shares outstanding.

**1097** (e) The tax imposed by this section shall be assessed, collected, and paid upon the same basis, in the same manner, and subject to the same provisions of law, including penalties, as the taxes imposed by sections 230 and 301 of the Revenue Act of 1918 (or by sections 230 and 301 of this Act, in the case of income received during the calendar year 1921), but no interest or penalties shall be due or payable thereon for any period prior to the date upon which the return is by this section required to be made and the first installment paid. The amount of tax paid by any shareholder or member of a personal service corporation pursuant to the provisions of subdivision (e) of section 218 of the Revenue Act of 1918 or subdivision (d) of section 218 of this Act shall be credited against the tax due from such corporation under this section upon the joint written application of such corporation and such shareholder or member or his representatives, heirs, or assigns, if such ap-

plication is filed with the Commissioner within six months from such date of entry of decree.

**1098** (f) Notwithstanding any other provision of law, no claim for a credit or refund of taxes paid under subdivision (e) of section 218 of the Revenue Act of 1918 or subdivision (d) of section 218 of this Act, may be filed after the expiration of six months from such date of entry of decree: *Provided, however,* That a personal service corporation of which no shareholder or member has filed such claim within such period of six months shall not be subject to the tax imposed by this section.

### Repeals.

**1099** Sec. 1400 [of the Revenue Act of 1921]. (a) That the following parts of the Revenue Act of 1918 are repealed, to take effect (except as otherwise provided in this Act) on January 1, 1922, subject to the limitations provided in subdivision (b):

\* \* \* \* \*

Title III (called "War-Profits and Excess-Profits Tax") as of January 1, 1921;

\* \* \* \* \*

**1100** (b) The parts of the Revenue Act of 1918 which are repealed by this Act shall (unless otherwise specifically provided in this Act) remain in force for the assessment and collection of all taxes which have accrued under the Revenue Act of 1918 at the time such parts cease to be in effect, and for the imposition and collection of all penalties or forfeitures which have accrued or may accrue in relation to any such taxes. In the case of any tax imposed by any part of the Revenue Act of 1918 repealed by this Act, if there is a tax imposed by this Act in lieu thereof, the provision imposing such tax shall remain in force until the corresponding tax under this Act takes effect under the provisions of this Act. \* \* \* .

**1101** For ¶1101 see page 427.



Form 1122—UNITED STATES INTERNAL REVENUE SERVICE

**INFORMATION RETURN OF SUBSIDIARY OR AFFILIATED CORPORATION****WHOSE NET INCOME AND INVESTED CAPITAL ARE INCLUDED IN RETURN OF A PARENT OR PRINCIPAL REPORTING CORPORATION FOR PURPOSES OF INCOME AND PROFITS TAXES****FOR CALENDAR YEAR 1921**

If return is for calendar year 1921, file it on or before March 15, 1922, with the Collector of Internal Revenue for the District in which the Subsidiary or Affiliated Corporation has its principal office.

If for a period other than a calendar year, the return should be filed on or before the 15th day of the third month following the close of such period.

(Date Received)

Or for period begun \_\_\_\_\_, 1920, and ended \_\_\_\_\_, 1921

(Name)

(Street and number or rural route)

(Post Office and State)

1. Date incorporated \_\_\_\_\_ Under laws of what State? \_\_\_\_\_

2. Kind of business \_\_\_\_\_

3. Par value of capital stock outstanding at beginning of taxable period:

(a) Common, \$ \_\_\_\_\_; (b) preferred, \$ \_\_\_\_\_

4. Name of parent corporation \_\_\_\_\_

5. Address of parent corporation \_\_\_\_\_

6. Internal revenue district in which consolidated return has been filed \_\_\_\_\_

(Give district, or city and State)

7. The department prefers that the entire tax shown on a consolidated return be paid by the parent or principal reporting corporation, instead of being apportioned among the corporations composing the affiliated group.

If apportionment is made, state the amount of income and profits taxes for the taxable period to be assessed

against the subsidiary or affiliated corporation making this return \$ \_\_\_\_\_

We, the undersigned, president and treasurer of the above-named subsidiary or affiliated corporation, being severally duly sworn, each for himself depose and says that the foregoing return, including the accompanying list (if any), has been examined by him and is to the best of his knowledge and belief a true and complete return of information made in good faith pursuant to the Revenue Act of 1921 and the Regulations issued thereunder.

SWORN to and subscribed before me this

\_\_\_\_\_ day of \_\_\_\_\_, 1922.

\_\_\_\_\_  
President.

(Signature of officer administering oath)

(Title)

\_\_\_\_\_  
Treasurer.

2-11246

# GOVERNMENT CONTRACTS PROFITS TAX RETURN FOR CALENDAR YEAR 1921

DO NOT WRITE IN THIS SPACE

Examined by

(Date received)

ATTACH THIS FORM  
TO YOUR INCOME TAX  
RETURN, FORM 1120,  
FOR THE CORRE-  
SPONDING TAXABLE  
PERIOD AS A PART  
OF THAT RETURN.

Or for period begun , 1920, and ended , 1921

Print plainly corporation's name and business address

(Name)

(Street and number)

(Post Office and State)

KIND OF BUSINESS

IS THIS A CONSOLIDATED RETURN?

## SCHEDULE I—NET INCOME.

Item.	Amount.
1. AVERAGE NET INCOME FOR PREWAR PERIOD (from Form 1120 for 1918, page 1, Schedule I, Item 6)	
2. NET INCOME FOR TAXABLE PERIOD (from Form 1120 for 1921, page 1, Schedule A, Item 27)	

## SCHEDULE II—INVESTED CAPITAL.

Item.	Amount.
1. INVESTED CAPITAL FOR TAXABLE PERIOD (from Form 1120 for 1921, page 1, Schedule B, Item 9)	
2. AVERAGE INVESTED CAPITAL FOR PREWAR PERIOD (from Form 1120 for 1918, page 1, Schedule II, Item 10)	
3. INCREASE OR DECREASE IN INVESTED CAPITAL FOR TAXABLE PERIOD AS COMPARED WITH AVERAGE PREWAR INVESTED CAPITAL (indicate decrease by "D")	

## SCHEDULE III—EXCESS PROFITS AND WAR PROFITS CREDITS.

EXCESS PROFITS CREDIT.	WAR PROFITS CREDIT.
1. Eight per cent of invested capital for taxable period (Item 1, Schedule II)	4. Average net income for prewar period (Item 1, Schedule I)
2. Exemption for domestic corporation (\$3,000)	5. Plus 10% of increase or minus 10% of decrease shown by Item 3, Schedule II
3. EXCESS PROFITS CREDIT (Item 1 plus Item 2)	6. (a) Total of (or difference between) Items 4 and 5, or (b) 10% of invested capital for taxable period (Item 1, Schedule II), whichever is larger
	7. Exemption for domestic corporation (\$3,000)
	8. WAR PROFITS CREDIT (Item 6 plus Item 7)

## SCHEDULE IV—COMPUTATION OF TAXES. WAR PROFITS AND EXCESS PROFITS TAX (BRACKETS ONE AND TWO).

1. Brackets.	2. Net Income (Item 2, Schedule I).	3. Excess Profits Credit (Item 8, Schedule III).	4. Balance Subject to Tax.	5. Rate.	6. Amount of Tax.
1. Net income not in excess of 20% of invested capital.				30%	
2. Balance of net income.				65%	
3. TOTALS					

## WAR PROFITS AND EXCESS PROFITS TAX (BRACKET THREE).

4. Net income for taxable period (Item 2, Schedule I)	7. Eighty per cent of Item 6
5. Less amount of War Profits Credit (Item 8, Schedule III)	8. Less Item 3, column 6 (if smaller than Item 7)
6. BALANCE	9. TAX IN BRACKET THREE (Item 7 minus Item 8; if Item 8 is the larger, make no entry)
10. Total War Profits and Excess Profits Tax as computed under Section 301(b)1 (Item 3, column 6, plus Item 9)	
11. Total War Profits and Excess Profits Tax, if computed under Sections 302 or 337 of the Revenue Act of 1921	

## SUMMARY—WAR PROFITS AND EXCESS PROFITS TAX.

12. Total War Profits and Excess Profits Tax computed under Sections 301(b), 302, or 337, whichever is the smallest	
13. Total Excess Profits Tax (Item 3 or 4, whichever is the smaller in column 6, Schedule D, Form 1120)	
14. That proportion of Item 12 which the income derived from Government contracts bears to the total net income.	
15. That proportion of Item 13 which the income not derived from Government contracts bears to the total net income.	
16. TOTAL WAR PROFITS AND EXCESS PROFITS TAX, Item 14 plus Item 15 (enter as Item 8, Schedule D, Form 1120)	

## GENERAL INSTRUCTIONS REGARDING TAX ON INCOME DERIVED FROM GOVERNMENT CONTRACTS.

In the case of a corporation which derives during the year 1921 a net income of more than \$10,000 from any Government contract or contracts made between April 6, 1917, and November 11, 1918, both dates inclusive, the tax shall be such a proportion of a tax computed at the rates for 1918, using the excess profits credit and the war profits credit applicable to that year, as the portion of the net income attributable to the Government contracts bears to the entire net income, plus such a proportion of a tax computed at the rates for 1921 as the amount of the remaining net income bears to the entire net income. See Section 301(a) of the Revenue Act of 1921.

Government contracts may include: (a) A contract with the United States, (b) a contract with an agency of the United States, (c) a contract with an agency of such agency, and (d) a subcontract with a contractor under any such contract, provided in every case the contract or subcontract was for the benefit of the United States. Unfavorable contracts subsequently ratified are regarded as though made when originally entered into. The Commissioner may require any contractor to file with him copies of his Government contracts entered into on and after April 6, 1917.

## INSTRUCTIONS CONCERNING THE FILLING IN OF SCHEDULES IN THIS RETURN.

### SCHEDULE I, NET INCOME, AND SCHEDULE II, INVESTED CAPITAL.

If advised that prewar data called for in Schedules I and II above have been revised by the Department, enter corrected amounts. Use space below for following schedules if sufficient.

### SUPPORTING SCHEDULE.

A schedule should be submitted respecting Government contracts made between April 6, 1917, and November 11, 1918, both dates inclusive, from which net income in an amount exceeding \$10,000 was derived during the taxable period. In the case of affiliated companies, this information should be shown separately for each company. This schedule should be in columnar form and should contain the following information as respects each contract:

- Amount of contract.
- Gross income from contract during period.
- Expenses directly applicable to each contract.

Total of each column should be shown.

There should also be shown in the most practicable form:

- Total gross income of corporation.
- Percentage which total of column (b) is of (a).
- Total general expenses, losses, and deductions of corporation.
- Amount of (c) allocated to Government contracts (total).
- Percentage which (c) is of (f).

If the allocation of general expenses, losses, and deductions differs from the percentage which the gross income from the Government contract or contracts bears to the total gross income, there shall be submitted a statement showing the items and the amounts thereof which have been otherwise allocated, and the reasons therefor. If a claim is made under Section 327 of the statute, gains, profits, commissions, or other income derived on a cost-plus basis from a Government contract or contracts made between April 6, 1917, and November 11, 1918, both dates inclusive, should be shown separately from income from Government contracts of different character.



<b>Form 1120</b> U. S. INTERNAL REVENUE	<h2 style="margin: 0;">CORPORATION INCOME AND PROFITS TAX RETURN</h2> <h3 style="margin: 0;">FOR CALENDAR YEAR 1921</h3>	Page 1 of Return (DO NOT WRITE IN THESE SPACES) Examined by _____ FIRST PAYMENT _____ (Cashier's Stamp) CASH CHECK M.O. CERT. OF IND.
<b>THIS RETURN SHOULD BE FILED NOT LATER THAN THE 15TH DAY OF THE THIRD MONTH FOLLOWING THE CLOSE OF THE TAXABLE PERIOD</b>	Or for period begun _____, 1920, and ended _____, 1921 PRINT PLAINLY CORPORATION'S NAME AND BUSINESS ADDRESS _____ (Name) _____ (Street and number) _____ (Post office and State)	

KIND OF BUSINESS \_\_\_\_\_ IS THIS A CONSOLIDATED RETURN? \_\_\_\_\_

#### SCHEDULE A—TAXABLE NET INCOME.

GROSS INCOME.							
1. Gross sales, less returns and allowances							
2. Less cost of goods sold, exclusive of items called for separately below (from Schedule A2)							
3. Gross income from operations other than trading or manufacturing, less allowances (from Schedule A3)							
4. Taxable interest on Liberty Bonds, etc. (from Schedule A4)							
5. Taxable interest from all other sources							
6. Rents							
7. Royalties							
8. Share of net income earned by personal service corporation (whether received or not)							
9. Dividends on stock of foreign and domestic corporations							
10. Gross income from all other sources (not including any amount reported in Item 23, below) (from Schedule A10)							
11. TOTAL OF ITEMS 1 TO 10							
DEDUCTIONS.							
12. Expenses (except amounts reported in Item 2 above, or called for separately below) (from Schedule A12)							
13. Compensation of officers (in whatever form paid) (from Schedule A13)							
14. Repairs (including labor, supplies, etc.) (from Schedule A14)							
15. Interest (see page 2 of Instructions, paragraph 9)							
16. Taxes (from Schedule A16)							
17. Bad debts (from Schedule A17)							
18. Exhaustion, wear and tear (including obsolescence) (from Schedule A18)							
19. Depreciation (from Schedule A19)							
20. Amortization of war facilities (from Schedule A20)							
21. TOTAL OF ITEMS 12 TO 20							
22. ITEM 11 MINUS ITEM 21							
23. Profit or loss on sales of capital assets and miscellaneous investments (from Schedule A23)							
24. Losses by fire, storm, etc. (from Schedule A24) (Extend difference between or sum of Items 23 and 24)							
25. Net income exclusive of deductions for dividends (Item 23 minus 24, extended)							
26. Dividends deductible under Section 234(a) 6 of the Revenue Act of 1921, (from Schedule A26)							
27. NET INCOME (Item 25 minus Item 26) (If return is for a period less than twelve months, see page 1 of Instructions, paragraph 10)							

#### SCHEDULE B—INVESTED CAPITAL.

1. Capital, surplus, and undivided profits at beginning of taxable period (from Schedule E, Item 11)							
2. Plus adjustments by way of additions (from Schedule F, Item 4)							
3. TOTAL							
4. Less adjustments by way of deductions (from Schedule G, Item 7)							
5. REMAINDER							
6. Plus or minus changes in invested capital during taxable period (net increase or decrease from Schedule E)							
7. TOTAL (on REMAINDER)							
8. Less deduction on account of inadmissible assets (from Schedule J)							
9. Invested capital for taxable period							

#### SCHEDULE C—EXCESS PROFITS CREDIT.

1. Eight per cent of invested capital for taxable period (Item 9 of Schedule B)							
2. Exemption (\$3,000) (except for a foreign corporation or a corporation satisfying the conditions provided in Section 262 of the Act)							
3. EXCESS PROFITS CREDIT (Item 1 plus Item 2)							

#### SCHEDULE D—COMPUTATION OF TAXES.

1. BRACKET.	2. TAX INCOME (Item 27, Schedule A).	3. EXCESS PROFITS CREDIT (Item 3, Schedule C).	4. BALANCE SUBJECT TO TAX.	5. RATE.	6. AMOUNT OF TAX.
1. Net income, not in excess of 20% of invested capital				20%	
2. Balance of net income				40%	
3. Totals computed under Section 301(a)					
4. EXCESS PROFITS TAX, if computed under Sections 302, 303, 304(c) or 337 of the Revenue Act of 1921 (see page 2 of Instructions, paragraph 14)					
5. Net income (Item 27, Schedule A)					
6. Less: Taxable interest on obligations of United States (Item 4, Schedule A)					
7. Excess profits tax (Item 5 or 4 whichever prevails, in column 6, Schedule D) or					
8. Profit taxes, if income from Government contract, exempted, \$10,000 (Item 16, Form 1120)					
9. Exemption \$3,000, for domestic corporation having a net income not exceeding \$25,000					
10. Balance (Item 5, less Items 6, 7, and 8, or Item 6, 8, and 9)					
			11. Income tax (10% of Item 10)		
			12. If net income does not exceed \$25,000, enter amount in excess of \$25,000		
			13. Total tax (Item 3 or 4 the lesser, or 8, plus Items 11 and 12)		
			14. Less: Income and profits taxes paid to foreign countries or governments of the United States (Attach Form 1118)		
			15. Tax paid at the source, (see Section 261 of the Revenue Act of 1921)		
			16. Balance of tax (Item 13 minus Items 14 and 15)		

An amended return must be plainly marked "Amended."

Checks and drafts will be accepted only if payable at par.

2-1073





Page 3 of Return.

## KIND OF BUSINESS.

1. By means of the key letters given below, identify the corporation's main income-producing activity with one of the general classes, and follow this by a special description of the business sufficient to give the information called for under each general class.

A.—Agriculture and related industries, including fishing, logging, ice harvesting, etc., and also the leasing of such property. State the product or products. B.—Mining and quarrying, including gas and oil wells, and also the leasing of such property. State the product or products. C.—Manufacturing. State the product and also the material if not implied by the name of the product. D.—Construction—excavations, buildings, bridges, railroads, ships, etc., also equipping and installing same with systems, devices, or machinery, without their manufacture. State nature of structures built, materials used, or kind of installations. E1.—Transportation—rail, water, local, etc. State the kind and special product transported, if any. E2.—Public utilities—gas (natural, coal, or kerosene), electric light or power (hydro or steam generated), heating (steam or hot water), telephone, waterworks or power. E3.—Storage—without trading or profit from sales (elevators, warehouses, stockyards, etc.). State product stored. E4.—Leasing (transportation or utilities). State kind of property. F.—Trading in goods bought and not produced by the trading concern. State manner of trade, whether wholesale, retail, or commission, and product handled. Sales with storage with profit primarily from sales. G.—Service—domestic, including hotels, restaurants, etc.; amusements, other professional, personal, or technical service. State the service. H.—Finance, including banking, real estate, insurance. I.—Concern not falling in above classes (a) because of combining several of them with no predominant business, or (b) for other reasons.

2. Concern whose business involves activity falling in two or more of the above general classes, where the same product is concerned, should report business as identified with but one of the above general classes; for example, concerns in A or B which also transport and market their own product exclusively or mainly, should still be identified with classes A or B; concerns in C (manufacturing) which own or control their source of material supply in A or B, and which also transport, sell, or install their own product exclusively or mainly, should be identified with manufacturing concerns in D; concerns in control or own source of supply of materials used exclusively or mainly in their constructive work concerns in E1 or E2 may own or control the source of their material or power concerns in F may transport or store their own merchandise, but its production would identify them with A, B, or C.

3. Agency.

(a) General class (use key letter designation).

(b) Main income-producing business (give specifically the information called for under each key letter, also whether acting as principal, or as agent on commission; state if inactive or in liquidation).

## OTHER CORPORATIONS IN SAME BUSINESS.

4. Enter on the following lines the names and addresses of five representative corporations in your locality or section of the country engaged in the same kind of business:

## INCORPORATION.

5. Date of incorporation \_\_\_\_\_
6. Under the laws of what State or country \_\_\_\_\_

## REORGANIZATION AND ACQUISITION OF MIXED AGGREGATES OF ASSETS.

7. Has the corporation, or any of its predecessors, been reorganized, or has it, or any of its predecessors, taken over a going business or acquired a mixed aggregate of tangible and intangible property, and paid for such property in whole or in part with stock or other securities since the close of the preceding taxable period?

8. If so, furnish a brief narrative history of the business and submit a statement showing:

(a) The name of the concern taken over (or from which the property was acquired);

(b) The nature of the assets and liabilities so acquired;

(c) The total par value of the stock issued therefor;

(d) The value at which each class of assets was carried on the books of the concern from which acquired (submit a balance sheet of the predecessor concern as at the date of acquisition or as at the close of its last accounting period prior thereto);

(e) The value at which each class of assets was carried on the books of the corporation making this return, and full details of any adjustments subsequently made pertaining thereto and the basis on which such valuation was made.

9. If patents, copyrights, secret processes or formulae, good will, trade-marks, trade brands, franchises, or other intangible property were acquired, state the basis on which this value was determined and how they were paid for.

10. If at the time of any purchase or reorganization as contemplated in question 7, any property was entered on the books of the reorganized concern or any vendee predecessor as a value in excess of that at which it was carried on the books of the vendor concern, state the basis on which this valuation was made.

## AFFILIATIONS WITH OTHER CORPORATIONS (TO BE ANSWERED BY EVERY CORPORATION).

11. Does the corporation own directly or control through closely affiliated interests or by a nominee or nominees over 70 per cent of the outstanding voting capital stock of another corporation or of other corporations?

12. Is over 70 per cent of your outstanding voting capital stock owned by another corporation or by two or more corporations that are affiliated?

13. Is over 70 per cent of your outstanding voting capital stock as well as over 70 per cent of the outstanding voting capital stock of another corporation or of other corporations owned or controlled by the same individual or partnership or by the same individuals or partnerships?

## SCHEDULE K.—BALANCE SHEETS.

Attach hereto balance sheets as at the beginning and end of the taxable period (preferably in parallel columns), showing as nearly as practicable the details called for below. (These balance sheets should be prepared from the books and should be in agreement therewith, or any differences should be reconciled, or, if this is a consolidated return, balance sheets should be furnished in accordance with paragraph 7 of page 1 of Instructions.)

ASSETS.—	ASSETS.—Continued.	ASSETS.—Continued.	LIABILITIES.
Cash (including cash in bank and on hand, certificates of deposit, etc.).	Investments.	Fixed assets.—continued.	Notes payable:
Trade accounts (balance deducting reserves for losses).	Stock of corporations.	Less: reserves for depreciation (show separately amount necessary to reach full asset's value).	To officers and stockholders.
Notes receivable from customers.	Due bills.		To others (including bank loans).
Notes receivable from notes receivable (to be classified).	Loans and advances.	New value.	Accounts payable:
Inventories.	To officers and employees.		Trade.
Prepaid expenses.	Deferred charges to future operations (to be classified).	Partials, good will, and other intangible assets.	Other.
Fixed assets:	Fixed assets.	Paid for in cash or other tangible property.	Accrued expenses and reserves, the charges resulting which are allowable deductions from income (to be classified).
Land and buildings.	Buildings.	Paid for in stock (other than stock dividends).	Reserves, the charges resulting which are not allowable deductions from income.
Equipment.	Equipment.	Created by stock dividends or otherwise.	Other reserves (to be classified).
Supplies.	Tools and motor equipment.	Discount:	Capital stock exceeding (to be classified).
Receivables:	Other receivables.	On bonds.	Surplus and undistributed profits.
U. S. bonds and obligations (each item to be stated separately).	Other (state character).	On stock.	
Example (national, State, etc.).		Total.	Total.

All corporations engaged in an interstate and intrastate trade or business and reporting to the Interstate Commerce Commission and to any national, State, municipal, or other public officer, may submit in lieu of above form, copies of their balance sheets prescribed by said Commission or State and municipal authorities, as at the beginning and end of the taxable period.

## QUESTIONS.

14. If the answer to questions 11, 12, and 13, or to any of them, is "yes," answer the following:

(a) Did the corporation file Affiliated Corporations Questionnaire, Form 519, for 1917 or subsequent taxable years? \_\_\_\_\_ If the answer to this question in "yes," a questionnaire is not required, except under the circumstances described in question 13. If the answer to this question is "no," and the answer to questions 11, 12, and 13, or to any of them, is "yes," procure from the Collector of Internal Revenue for your district Form 519, which shall be filled out and filed as a part of this return. If the answer to this question is "no," question (b) need not be answered.

(b) Did substantially the same conditions, as are set out in the questionnaire filed for 1920 or prior year, obtain during the entire taxable period 1921? \_\_\_\_\_ If the answer to this question is "no," a statement, setting forth the particulars in which the situation has changed, should be attached to and made a part of this return. If there have been substantial changes in stockholdings, a complete schedule of such changes should be submitted in the form prescribed in Tables 3 and 4 of the questionnaire. If there are companies other than those covered by the questionnaire for 1920 or prior years which, applying the tests contained in questions 11, 12, or 13, may have come into the affiliated group since 1920, a questionnaire, Form 519, is required for the entire group for the taxable period.

## VALUATION OF CAPITAL STOCK.

15. What was the fair value of the total capital stock of the corporation as determined in the last assessment, if any, of the capital stock tax? \$ \_\_\_\_\_ Date of that assessment \_\_\_\_\_

## PREDECESSOR BUSINESS.

16. Did the corporation file a return under the same name for the preceding taxable period? \_\_\_\_\_ If not, was the corporation in any way an outgrowth, result, continuator, or reorganization of a business or businesses in existence during this or the preceding taxable period? \_\_\_\_\_ If answer is "yes," give name and address of each predecessor business.

## BASIS OF RETURN.

17. Is this return made on the basis of actual receipts and disbursements? \_\_\_\_\_ If not, describe fully what other basis or method was used in computing net income.

## GOVERNMENT CONTRACTS.

18. Have any adjustments been made during the taxable period on account of contract or contracts with the Government or its agencies or in any Government contract or contracts from which the corporation derived income directly or indirectly, through the operations of a claim bond or otherwise? \_\_\_\_\_ If the answer to this question is "yes," state the amounts involved \$ \_\_\_\_\_; whether or not such amounts are included in this return \_\_\_\_\_; and, if not, was an amended return, accounting for the additional income, filed for the taxable period in which the contract was terminated? \_\_\_\_\_ Submit a schedule showing full particulars of the contract, date entered into, date the work ceased under said contract or contracts, and the amount and nature of the adjustment.

## AMORTIZATION.

19. Has amortization been claimed? \_\_\_\_\_ If the answer to this question is "yes," state for what year \_\_\_\_\_ Amount \$ \_\_\_\_\_

## LIST OF ATTACHED SCHEDULES.

Enter below a list of all schedules accompanying this return, giving for each a brief title and the schedule number.





## INSTRUCTIONS FOR CORPORATION RETURN.

## LIABILITY FOR FILING RETURNS.

1. **Corporations generally.**—Every domestic or resident corporation, joint-stock company, association, or insurance company not specifically exempted by Section 231 of the Revenue Act of 1921, whether or not having any net income, must file a return.

2. A corporation, having a net income of less than \$3,000 for the taxable period need not file in the schedule pertaining to excess profits tax, but if the net income is \$3,000 or more, it is subject to the excess profits tax and must file a complete return on this form.

3. **Government Contracts.**—In addition thereto, if net income in excess of \$10,000 was derived during the taxable period from a Government contract, Form 1120S should be secured from the Collector of Internal Revenue for your district and filed as a part of this return.

4. **Corporations in Possessions of the United States.**—Domestic corporations within the possessions of the United States (except the Virgin Islands) may report as gross income only gross income from sources within the United States; provided, (a) 50 per cent or more of the total gross income for the three-year period immediately preceding the close of the taxable year (or such part thereof as may be applicable) was derived from sources within a possession of the United States; and (b) 50 per cent or more of the total gross income for such three-year period or applicable part thereof was derived from the active conduct of a trade or business within a possession of the United States.

However, a corporation entitled to the above benefits is not entitled to the specific exemption of \$3,000 in computing the excess profits tax. (See Sections 262 and 312, Revenue Act of 1921.)

5. **Foreign Corporations.**—A foreign corporation subject to the law, regardless of the amount of its net income, is required to file a return with the Collector in whose district is located its principal office or agency through which it transacted the business in the United States. If it has no office or agency in the United States, the return should be filed with the Collector of Internal Revenue, Baltimore, Maryland. The net income should be computed in accordance with Section 217 of the Revenue Act of 1921.

6. **Personal Service Corporations.**—Personal service corporations must file a return on Form 1065.

## CONSOLIDATED RETURNS.

7. The parent or principal reporting company of affiliated corporations as defined in Section 240 of the Act must file a consolidated return on this form with the collector of the district in which its principal office is located and attach thereto a schedule showing the names and addresses of all affiliated corporations in the group, and if the tax is apportioned among these corporations, the amount allocated to each. (See paragraph 9, below.) Each of the other affiliated corporations shall file Form 1122 in the office of the Collector of its district.

Consolidated invested capital must be computed as at the beginning of the taxable period of the parent or principal reporting company and consolidated income must be computed on the basis of its taxable period.

All supplementary and supporting schedules should be prepared in columnar form, one column being provided for each corporation included in the consolidation, one column for a total of like items before adjustments are made, one column for intercompany eliminations and adjustments, and one column for a total of like items after giving effect to the eliminations and adjustments. The items included in the column for eliminations and adjustments should be symbolized so as to readily identify contra items affected, and if necessary, in order to give a correct understanding of these entries, suitable explanations should be appended.

8. If one domestic corporation owns 95 per cent or more of the outstanding voting stock of another, or if 95 per cent or more of the outstanding voting stock of two or more domestic corporations is owned by the same individual or individuals, partnership or partnerships, in substantially the same proportion, a consolidated return must be filed by such corporations, except that the purpose of the statute being to prevent the avoidance or reduction of tax liability, corporations engaged in entirely distinct and unrelated lines of business, there being no common dealings between them giving rise to opportunity to avoid or reduce tax liability, shall not be required to file a consolidated return. If the ownership is less than 95 per cent of the outstanding voting stock, but exceeds 70 per cent, the parent or principal corporation of any group of affiliated corporations must furnish the information called for in questions 11 to 14, page 3.

9. The Department prefers that the entire tax shown on a consolidated return be paid by the parent or principal reporting corporation, instead of being apportioned among the corporations composing the affiliated group.

If apportionment is made, each subsidiary or affiliated corporation should state on its Form 1122 the amount of income and profit taxes to be assessed against it for the taxable period.

## PERIOD COVERED.

10. The taxable period is the calendar year or the fiscal period ended in such calendar year, and the net income shall be computed upon the basis of the corporation's annual accounting period (calendar year or fiscal period) in accordance with the method of keeping the books, unless such method does not clearly reflect the income. The accounting period established for the taxable year immediately preceding must be adhered to unless permission has been received from the Commissioner to make a change.

In the case of a return for a period of less than one year, the net income shall be placed on an annual basis by multiplying the amount

thereof by twelve and dividing by the number of months included in such period; and the tax shall be such part of a tax computed on such annual basis as the number of months in such period is of twelve months.

If the period for which the first or final return is made includes fractions of months, there shall be added to the number of complete months as many thirtieths of a month as there are days in the fractional parts of months.

11. If a corporation changes its accounting period, it shall as soon as possible give to the Collector for transmission to the Commissioner written notice of such change and of its reasons therefor. Upon approval by the Commissioner, the corporation shall thereafter make its returns upon the basis of the new accounting period. See Sections 212(c) and 226, Revenue Act of 1921.

## TIME AND PLACE FOR FILING.

12. The return must be sent to the Collector of Internal Revenue for the district in which the corporation's principal office is located, so as to reach the Collector's office on or before the fifteenth day of the third month following the close of the taxable period. In the case of a foreign corporation not having any office or place of business in the United States the return shall be filed on or before the fifteenth day of the sixth month following the close of the taxable period.

13. The Collector is authorized to grant an extension of not more than thirty days for filing returns in cases of absence or sickness. In meritorious cases the Commissioner is authorized to grant a further extension.

## SIGNATURES AND VERIFICATION.

14. The return shall be sworn to by the president, vice president, or other principal officer and by the treasurer or assistant treasurer. The return of a foreign corporation having an agent in the United States shall be sworn to by such agent. If receivers, trustees in bankruptcy, or assignees are operating the property or business of the corporation, such receivers, trustees, or assignees shall execute the return for such corporation, under oath.

## PAYMENT OF TAXES.

15. The tax should be paid by sending or bringing with the return a check or money order drawn to the order of "Collector of Internal Revenue at (insert name of city and State)."

16. Do not send cash through the mail or pay it in person except at the office of the Collector.

17. The total tax may be paid at the time of filing the return or in four equal installments, as follows:

The first installment shall be paid at the time fixed by law for filing the return; the second installment shall be paid on the fifteenth day of the third month; the third installment on the fifteenth day of the sixth month; and the fourth installment on the fifteenth day of the ninth month after the time fixed by law for filing the return.

## PENALTIES.

## For Making False or Fraudulent Return.

18. Not exceeding \$10,000 or not exceeding one year's imprisonment, or both, in the discretion of the court, and, in addition, 50 per centum of the total tax evaded.

## For Failing to Make Return on Time.

19. Not more than \$1,000, and, in addition, 25 per centum of the total amount of the tax.

## For Failing to Pay Tax When Due or Understatement of Tax, Through Negligence, Etc.

20. Five per centum of the tax due but unpaid plus interest at the rate of 1 per centum per month during the period in which it remains unpaid.

## WORKING PAPERS.

21. Every corporation should preserve, available for inspection by a revenue officer, working papers showing—

(a) The balance in each account on the corporation's books that was used in preparing Schedule A.

(b) The amount deducted from each such balance on account of each class of nonexemptable income, allowable deductions, and other adjustments indicated in Schedule L, with a reference to the number of the item in Schedule L in which each amount so deducted was included.

(c) The remainder of each such balance, analyzed to show the amount included in each item of Schedule A, with a reference to the number of the item in Schedule A in which each such amount was included.

## INFORMATION AT THE SOURCE.

22. Every corporation making payments of salaries, wages, interest, rent, commissions, or other fixed or determinable income of \$1,000 or more during the calendar year, to any individual or partnership, is required to make a true and accurate return to the Commissioner of Internal Revenue showing the nature of such payments and the name and address of the recipient. Forms 1099 and 1098, for reporting such information, will be furnished by any collector of internal revenue. Such returns of information covering the calendar year 1921 must be forwarded to the Commissioner of Internal Revenue, Sorting Section, Washington, D. C., in time to be received not later than March 15, 1922.

## INSTRUCTIONS REGARDING INCOME, CREDITS, COMPUTATION OF TAX, ETC.

## GROSS INCOME AND DEDUCTIONS.

1. Railroad corporations, banks, insurance companies, and other corporations required to submit statements of income and expenses to any national, State, municipal, or other public officer may submit instead of Schedule A a statement of income and expenses in the form in which submitted to such officer. In such case the taxable net income will be reconciled by annexing Schedule L with the net profit shown by the income and expense statement submitted, and should be entered as Item 27, Schedule A, page 1.

2. A life insurance company issuing life insurance and annuity contracts (including contracts of combined life, health, and accident insurance), as defined by Section 242 of the Revenue Act of 1917, shall file its tax return on Form 11005, instead of Form 1120.

3. An insurance company (other than a company taxed under Section 242 of the Act) issuing policies covering life, health, and accident insurance combined in one policy issued on the weekly premium payment plan, continuing for life, and not subject to cancellation, shall file its return on this form, and report as a deduction in Schedule A12 subject to the approval of the Commissioner, such portion of the net addition (not required by law) made within the taxable period to reserve funds as may be required for the protection of the holders of such policies only.

4. An insurance company (other than a life insurance company) should report as a deduction in Schedule A12 of this form, (e) the net addition required by law to be made within the taxable period to reserve funds (including in the case of an assessment insurance company the actual deposit of same with State or Territorial officers pursuant to law as additions to guarantee or reserve funds), and (3) the sum of other dividends paid within the taxable period on policy and annuity contracts.

5. A mutual marine insurance company should report as Item 3, Schedule A, of this form, the gross premiums collected and received, less amounts paid for reinsurance, and report as a deduction in Schedule A12 amounts repaid to policyholders on account of premiums previously paid by them and interest paid upon such amounts between ascertainment and the payment thereof.

6. The receipts of a shipowner's mutual protection and indemnity association, not organized for profit, and no part of the net earnings of which inure to the benefit of any private stockholder or member, are exempt from taxation, but such association shall be subject as a corporation to the tax upon its net income from interest, dividends, and rents.

7. A mutual insurance company (including interinsurance and reciprocal undertakers, but not including a mutual life or mutual marine insurance company) requiring its members to make premium deposits to provide for losses and expenses, should report in Schedule A12 of this form, the amount of premium deposits returned to its policyholders and the amount of premium deposits retained for the payment of losses, expenses, and reinsurance reserves (unless otherwise allowed in Schedule A).

8. Incidental repairs, which do not add to the value or appreciably prolong the life of property, are deductible as expenses (Item 14, Schedule A). Expenditures for new building, machinery, equipment, or for permanent improvement or betterments which increase the value of the property are chargeable to capital account. Expenditures for repairing or replacing property are not deductible under this or any other item of the return. Such expenditures are chargeable to capital account or to depreciation reserve, depending on the treatment of depreciation on the books of the taxpayer.

9. The amount of interest deductible in Item 15, Schedule A, is the amount of interest paid within the taxable period on the corporation's indebtedness, except on indebtedness incurred or continued to purchase or carry obligations or securities (other than obligations of the United States issued after September 24, 1917, and originally subscribed for by the corporation), the interest upon which is wholly exempt from taxation. (See Sections 234(a) 2 and 234(b) of the Revenue Act of 1921.)

10. The amount deductible on account of depreciation in Item 18, Schedule A, is an amount charged off which fairly measures the loss during the year in the value of physical property by reason of exhaustion, wear, tear, and obsolescence. Such an amount should be determined upon the basis of the cost of the property or, if acquired prior to March 1, 1918, the fair market value on that date and the probable number of years remaining of its useful life. The capital sum to be replaced should be charged off over the probable life of the property either in equal annual installments or in accordance with any other recognized trade practice, such as an apportionment of the capital sum over units of production. Whatever plan or method is adopted must be reasonable and should be described in the return. Stocks, bonds, and like securities are not subject to exhaustion, wear and tear within the meaning of the law.

11. If property is compulsorily or involuntarily converted into cash or its equivalent as a result of (a) its destruction in whole or in part, (b) theft or expropriation, or (c) an exercise of the power of requisition or condemnation, or the threat or imminence thereof, and if the taxpayer proceeds forthwith in good faith, under regulations prescribed by the Commissioner with the approval of the Secretary, to expend the proceeds of such conversion in the acquisition of other property of a character similar or related in service or use to the property so converted, or in the acquisition of 80 per centum or more of the stock of another corporation owning such other property, or in the establishment of a replacement fund, then there shall be allowed as a deduction such portion of the gain derived as the portion of the proceeds so expended bears to the entire proceeds. The gross receipts and deductions claimed should be included in Schedule A23. (See Section 232(c) 14 of the Revenue Act of 1921.)

## CREDIT FOR INCOME AND PROFITS TAXES PAID TO FOREIGN COUNTRIES OR POSSESSIONS OF THE UNITED STATES.

12. If a credit is claimed in Item 14, Schedule D, a copy of Form 1115, completely filled out and sworn to or affirmed, must be submitted with this return. If credit is sought for taxes already paid, the form must have attached to it the receipt for such such tax payment. If credit is sought for taxes accrued, the form must have attached to it the return on which each such accrued tax was based.

13. When a credit is claimed for accrued taxes, the Commissioner may, as a condition precedent to the allowance of the credit, require the corporation to give a bond (Form 1119), with sureties satisfactory to and to be approved by him in such penal sum as he may require, conditioned for the payment by the taxpayer of any amount of taxes found due of the taxes when paid differ from the amount claimed in respect thereof.

## PROVISIONS AFFECTING COMPUTATION OF TAX.

14. Schedule D, "Computation of Tax," may be subject to one or more of the following provisions:

(a) Return for a fiscal year.—If return is for a fiscal year ended in 1921, the tax should be computed in accordance with Sections 205, 232(c), and 335(c) of the Revenue Act of 1921.

(b) Limitation on income tax.—If the net income reported as Item 5, Schedule D, is more than \$25,000 the tax of 10 per centum imposed by Section 220 of the Act on the amount of the net income shall not exceed the tax which would be payable if the \$25,000 credit were allowed, plus the amount of the net income in excess of \$25,000.

(c) Limitations on excess profits tax.—The maximum excess profits tax imposed shall in no case be more than 20 per cent of the net income in excess of \$10,000 and not in excess of \$20,000 plus 40 per cent of the net income in excess of \$30,000 (Section 302), unless net income amounting to more than \$10,000 was derived from a Government contract, when the tax on such income shall be assessed under Section 301(b), in which case the maximum excess and war profits tax imposed upon this corporation of the net income shall not be more than 50 per cent of the amount of net income in excess of \$5,000 and not in excess of \$30,000 plus 80 per cent of the amount of net income in excess of \$20,000. (See Section 302.)

(d) Tax of corporation whose income is derived in part from "Personal Service."—If part of the net income (not less than 30 per cent) is derived from a separate trade or business of the character of "personal services" such tax shall be computed in accordance with the provisions of Section 303 of the Act.

(e) Tax on corporation engaged in mining of gold.—If a corporation is engaged in the mining of gold, its excess profits tax shall be that proportion of Item 3, Schedule D, which the net income not derived from the mining of gold bears to the total net income. (See Section 304(c) of the Act.)

(f) Tax on profits from sale of mineral deposits.—In the case of a bona fide sale of mines, oil, or gas wells, or any interest therein, where the principal value of the property has been determined by prospecting or exploration and discovery work done by the taxpayer, the portion of the excess profits tax attributable to such sale shall not exceed 20 per cent of the selling price of such property or interest. (See Section 337 of the Act.)

The first step is to find the excess profits tax computed without regard to this provision; the second is to find of the tax thus computed such portion as the net income from the sale bears to the total net income. If this portion equals or does not exceed 20 per cent of the selling price, then no adjustment is permitted. Should such portion exceed 20 per cent of the selling price, the tax will be that portion of the excess profits tax which the net income not attributable to the sale bears to the total net income plus 20 per cent of the selling price of the mineral deposits.

15. Statement of basis of claims.—If a corporation claims the benefit of any of the provisions outlined in (d), (e), or (f), it should attach to the return a complete statement of the basis for such claim and a computation of the tax payable in the event that such claim is allowed. The amount of tax computed should be entered in Schedule D.

## SPECIAL CASES.

16. Definition of special cases.—Section 327 of the Act provides that in the following cases the tax shall be determined as provided in Section 328:

(a) Where the Commissioner is unable to determine the invested capital as provided in Section 325.

(b) In the case of a foreign corporation or a corporation entitled to the benefits of Section 262 of the Revenue Act of 1921. See paragraph 4, page 1 of Instructions.

(c) Where a mixed aggregate of tangible property and intangible property has been paid in for stock for stock and bonds and the Commissioner is unable satisfactorily to determine the respective values of the several classes of property at the time of payment, or to distinguish the classes of property paid in for stock and for bonds, respectively.

(d) Where, upon application by the corporation, the Commissioner finds and declares of record that the tax if determined without benefit of this section would, owing to abnormal conditions affecting the capital or income of the corporation, work upon the corporation an exceptional hardship evidenced by gross disproportion between the tax computed without benefit of this section and the tax computed by reference to the representative corporations specified in Section 328. This subdivision shall not apply to any case: (1) in which the tax (computed without benefit of this section) is high merely because the corporation earned within the taxable period a high rate of profit upon a normal invested capital, nor (2) in which 50 per centum or more of the gross income of the corporation for the taxable period (computed under Section 233 of the Act) consisted of gains, profits, commissions, or other income derived on a cost-plus basis from a Government contract or contracts made between April 6, 1917, and November 11, 1918, both dates inclusive.

17. Treatment of special cases.—In the cases specified in Section 327 the tax will be specially determined under the provisions of Section 328. A corporation which comes within the provisions of subdivision (d) of Section 327 (paragraph 14, above) may make application for assessment under the provisions of Section 328, which application shall be attached to its return in the form of a statement setting forth in full: (a) The reasons why the tax should be so determined; (b) the facts upon which such reasons are based; (c) an exact description of each trade or business or important branch of a trade or business carried on by it; (d) a statement of the invested capital and net income for each year since the beginning of the prewar period; and (e) a statement showing the amount of gains, profits, commissions, or other income derived on a cost-plus basis from Government contracts made between April 6, 1917, and November 12, 1918, both dates inclusive, and showing the per cent which such income is of the total income of the corporation.

18. Return in special cases.—Corporations other than foreign corporations making claim for assessment under Section 328 of the Act should answer all questions and file all schedules as far as possible and attach a statement explaining why it is impracticable to fill out the entire return.

## UNDISTRICTED PROFITS TAXABLE TO STOCKHOLDERS.

19. If any corporation, however created or organized, is formed or availed of for the purpose of preventing the imposition of the surtax upon its stockholders or members through the means of permitting gains and profits to accumulate instead of being divided or distributed, there shall be levied, collected and paid for each taxable year upon the net income of such corporation a tax equal to twenty-five per cent (25%) of the amount thereof, which shall be in addition to the tax imposed by Section 230, Revenue Act of 1921, and shall be computed, collected and paid upon the same basis and in the same manner and subject to the same provisions of law, including penalties, as that tax. (See Section 220, Revenue Act of 1921.)

UNOFFICIAL FEDERAL EYES

9-34745



Form 1120 S  
U. S. INTERNAL REVENUE**GOVERNMENT CONTRACTS PROFITS TAX RETURN**  
FOR FISCAL YEAR ENDING IN 1922

DO NOT WRITE IN THIS SPACE

Examined by

(Date retained)

ATTACH THIS FORM  
TO YOUR INCOME TAX  
RETURN, FORM 1120A,  
FOR THE CORRE-  
SPONDING TAXABLE  
PERIOD AS A PART  
OF THAT RETURN.

Fiscal year begun ....., 1921, and ended ....., 1922

Print plainly corporation's name and business address

(Name)

(Street and number)

(Post Office and State)

KIND OF BUSINESS

IS THIS A CONSOLIDATED RETURN?

**SCHEDULE I—NET INCOME.**

Item	Amount
1. AVERAGE NET INCOME FOR PREWAR PERIOD (from Form 1120 for 1918, page 1, Schedule I, Item 6).....	7
2. NET INCOME FOR TAXABLE PERIOD (from Form 1120A for fiscal year ending in 1922, page 1, Schedule A, Item 27).....	8

**SCHEDULE II—INVESTED CAPITAL.**

Item	Amount
1. INVESTED CAPITAL FOR TAXABLE PERIOD (from Form 1120A for fiscal year ending in 1922, page 1, Schedule B, Item 9).....	3
2. AVERAGE INVESTED CAPITAL FOR PREWAR PERIOD (from Form 1120 for 1918, page 1, Schedule II, Item 10).....	4
3. INCREASE OR DECREASE IN INVESTED CAPITAL FOR TAXABLE PERIOD AS COMPARED WITH AVERAGE PREWAR INVESTED CAPITAL (indicate decrease by "D").....	5

**SCHEDULE III—EXCESS PROFITS AND WAR PROFITS CREDITS.**

EXCESS PROFITS CREDIT.		WAR PROFITS CREDIT.	
1. Eight per cent of invested capital for taxable period (Item 1, Schedule II).....	6	4. Average net income for prewar period (Item 1, Schedule I).....	7
2. Exemption for domestic corporation (\$3,000).....	7	5. Five 10% of increase or minus 10% of decrease shown by Item 3, Schedule I.....	8
3. Excess Profits Credit (Item 1 plus Item 2).....	8	6. (a) Total of (a) difference between Items 1 and 5, of (b) 10% of invested capital for taxable period (Item 1, Schedule II), whichever is larger.....	9
		7. Exemption for domestic corporation (\$3,000).....	10
		8. War Profits Credit (Item 6 plus Item 7).....	11

**SCHEDULE IV—COMPUTATION OF TAXES.****WAR PROFITS AND EXCESS PROFITS TAX (BRACKETS ONE AND TWO).**

1. Brackets.	2. War Income (Item 3, Schedule I)	3. Excess Profits Credit (Item 8, Schedule III)	4. Balance Subject to Tax	5. Rate.	6. Amount of Tax.
1. Net income not in excess of 20% of invested capital.....				30%	
2. Balance of net income.....				65%	
3. TOTALS.....					

**WAR PROFITS AND EXCESS PROFITS TAX (BRACKET THREE).**

4. Net income for taxable period (Item 2, Schedule I).....	5. Less amount of War Profits Credit (Item 8, Schedule III).....	6. BALANCE.....	7. Eighty per cent of Item 6.....	8. Less Item 3, column 6 (if smaller than Item 7).....	9. TAX IN BRACKET THREE (Item 7 minus Item 8; if Item 8 is the larger, make no entry).....
10. Total War Profits and Excess Profits Tax as computed under Section 301(b) (Item 3, column 6, plus Item 9).....					

**SUMMARY—WAR PROFITS AND EXCESS PROFITS TAX.**

12. Total War Profits and Excess Profits Tax computed under Sections 301(b), 302, or 337, whichever is the smallest.....	
13. Total Excess Profits Tax (Item 3 or 4, whichever is the smaller in column 6, Schedule D, Form 1120A).....	
14. That proportion of Item 12 which the income derived from Government contracts bears to the total net income.....	
15. That proportion of Item 13 which the income not derived from Government contracts bears to the total net income.....	
16. TOTAL WAR PROFITS AND EXCESS PROFITS TAX, Item 12 plus Item 15 (enter as Item 8, Schedule D, Form 1120A).....	

**GENERAL INSTRUCTIONS REGARDING TAX ON INCOME DERIVED FROM GOVERNMENT CONTRACTS.**

Every corporation which derives during the calendar year 1921 a net income of more than \$10,000 from any Government contract or contracts made between April 6, 1917, and November 11, 1918, both dates inclusive, the tax shall be such a proportion of a tax computed at the rates for 1918, upon the excess profits credit and the war profits credit applicable to that year, as the portion of the net income attributable to the Government contracts bears to the entire net income, plus such a proportion of a tax computed at the rates for 1921 as the amount of the remaining net income bears to the entire net income. See Section 301(b) of the Revenue Act of 1921.

Government contracts may include: (a) A contract with the United States; (b) a contract with an agency of the United States; (c) a contract with an agency of such agency; and (d) a subcontract with a contractor under any such contract, provided in every case the contract or subcontract was for the benefit of the United States. Unfavorable contracts subsequently ratified are treated as though made when originally entered into. The Commissioner may require any contractor to file with him copies of his Government contracts entered into on and after April 6, 1917.

**INSTRUCTIONS CONCERNING THE FILLING IN OF SCHEDULES IN THIS RETURN.**

**SCHEDULE I, NET INCOME, AND SCHEDULE II, INVESTED CAPITAL.**  
It is advised that prewar data called for in Schedules I and II above have been revised by the Department, under corrected amounts. Use space below for following schedules if sufficient.

**SUPPORTING SCHEDULE.**

A schedule should be submitted respecting Government contracts made between April 6, 1917, and November 11, 1918, both dates inclusive, from which a net income in excess of \$10,000 was derived during the calendar year 1921. In the case of affiliated companies, this information should be shown separately for each company. This schedule should contain columns for and should contain the following information as respects each contract:  
(a) Amount of contract.  
(b) Gross income from contract during period.  
(c) Expenses directly applicable to each contract.  
Totals of each column should be shown.

There should also be shown in the most practicable form:

- (d) Total gross income of corporation.  
(e) Percentage which total of column (d) is of (c).  
(f) Total general expenses, losses, and deductions of corporation.  
(g) Amount of (f) allocated to Government contracts (total).  
(h) Percentage which (g) is of (f).

If the allocation of general expenses, losses, and deductions differs from the percentage which the gross income from the Government contract or contracts bears to the total gross income, there shall be submitted a statement showing the items and the amounts thereof which have been otherwise allocated, and the reasons therefor. It is claimed as made under Section 337 of the statute, gains, profits, commissions, or other income derived on a contract made from a Government contract or contracts made between April 6, 1917, and November 11, 1918, both dates inclusive, should be shown separately from income from Government contracts of different character.

# INFORMATION RETURN OF SUBSIDIARY OR AFFILIATED CORPORATION

WHOSE NET INCOME AND INVESTED CAPITAL ARE INCLUDED IN RETURN OF A PARENT OR PRINCIPAL REPORTING CORPORATION FOR PURPOSES OF INCOME AND PROFITS TAXES

FOR CALENDAR YEAR 1922

If return is for calendar year 1922, file it on or before March 15, 1923, with the Collector of Internal Revenue for the District in which the Subsidiary or Affiliated Corporation has its principal office.

If for a period other than a calendar year, the return should be filed on or before the 15th day of the third month following the close of such period.

Or for period begun \_\_\_\_\_, 1921, and ended \_\_\_\_\_, 1922

(Date Received)

(Name)

(Street and number or rural route)

(Post Office and State)

1. Date incorporated \_\_\_\_\_ Under laws of what State? \_\_\_\_\_

2. Kind of business \_\_\_\_\_

3. Par value of capital stock outstanding at beginning of taxable period:

(a) Common, \$ \_\_\_\_\_; (b) preferred, \$ \_\_\_\_\_

4. Name of parent corporation \_\_\_\_\_

5. Address of parent corporation \_\_\_\_\_

6. Internal revenue district in which consolidated return has been filed \_\_\_\_\_

(Give district, or city and State)

7. The department prefers that the entire tax shown on a consolidated return be paid by the parent or principal reporting corporation, instead of being apportioned among the corporations composing the affiliated group.

If apportionment is made, state the amount of income and profits taxes for the taxable period to be assessed against the subsidiary or affiliated corporation making this return \$ \_\_\_\_\_

We, the undersigned, president and treasurer of the above-named subsidiary or affiliated corporation, being severally duly sworn, each for himself deposes and says that the foregoing return, including the accompanying list (if any), has been examined by him and is to the best of his knowledge and belief a true and complete return of information made in good faith pursuant to the Revenue Act of 1921 and the Regulations issued thereunder.

Sworn to and subscribed before me this

\_\_\_\_\_ day of \_\_\_\_\_, 1923.

President.

(Signature of officer administering oath)

7-12310

(L. H. S.)

Treasurer.



# CORPORATION INCOME AND PROFITS TAX RETURN

## FOR FISCAL YEAR ENDING IN 1922

THIS RETURN SHOULD  
BE FILED NOT LATER  
THAN THE 15TH DAY  
OF THE THIRD MONTH  
FOLLOWING THE CLOSE  
OF THE FISCAL  
YEAR

Fiscal year begun ....., 1921, and ended ....., 1922

PRINT PLAINLY CORPORATION'S NAME AND BUSINESS ADDRESS

(Name)

(Street and number)

(Post office and State)

FIRST PAYMENT

(Cashier's Stamp)

CASH CHECK M. O. CERT. OF IND.

KIND OF BUSINESS

IS THIS A CONSOLIDATED RETURN?

### SCHEDULE A—TAXABLE NET INCOME.

#### GROSS INCOME.

- Gross sales, less returns and allowances.
- Less cost of goods sold, exclusive of items called for separately below (from Schedule A2).
- Gross income from operations other than trading or manufacturing, less allowances (from Schedule A3).
- Taxable interest on Liberty Bonds, etc. (from Schedule A4).
- Taxable interest from all other sources.
- Rents.
- Royalties.
- Share of net income earned by personal service corporation prior to January 1, 1922 (whether received or not).
- Dividends on stock of foreign and domestic corporations.
- Other income (not including any amount reported in Item 23, below) (from Schedule A10).
- TOTAL OF ITEMS 1 TO 10.

#### DEDUCTIONS.

- Expenses (except amounts reported in Item 2 above, or called for separately below) (from Schedule A12).
- Compensation of officers (in whatever form paid) (from Schedule A13).
- Repairs (including labor, supplies, etc.) (from Schedule A14).
- Interest (see page 2 of Instructions, paragraph 9).
- Taxes (from Schedule A16).
- Bad debts (from Schedule A17).
- Exhaustion, wear and tear (including obsolescence) (from Schedule A18).
- Depletion (from Schedule A19).
- Amortization of war facilities (from Schedule A20).
- TOTAL OF ITEMS 12 TO 20.
- ITEM 11 MINUS ITEM 21.
- Profit or loss on sales of capital assets and miscellaneous investments (from Schedule A23).
- Losses by fire, storm, etc. (from Schedule A24). (Extend difference between or sum of Items 23 and 24).
- Net income exclusive of deductions for dividends (Item 22 plus or minus Item 24, as extended).
- Dividends deductible under Section 234(a) of the Revenue Act of 1921 (from Schedule A26).
- NET INCOME (Item 25 minus Item 26). (If return is for a period less than twelve months, see page 1 of Instructions, paragraph 10).

### SCHEDULE B—INVESTED CAPITAL.

- Capital, surplus, and undivided profits at beginning of taxable period (from Schedule E, Item 1).
- Plus adjustments by way of additions (from Schedule F, Item 4).
- TOTAL.
- Less adjustments by way of deductions (from Schedule G, Item 7).
- REMAINDER.
- Plus or minus changes in invested capital during taxable period (net increase or decrease from Schedule H).
- TOTAL (on Revenues).
- Less deduction on account of inadmissible assets (from Schedule J).
- Invested capital for taxable period.

### SCHEDULE C—EXCESS PROFITS CREDIT.

- Eight per cent of invested capital for taxable period (Item 9 of Schedule B).
- Exemption (\$3,000) (except for a foreign corporation or a corporation satisfying the conditions provided in Section 262 of the Act).
- Excess Profits Credit (Item 1 plus Item 2).

### SCHEDULE D—COMPUTATION OF TAXES.

1. BRACKETS.	2. NET INCOME (Item 27, Schedule A).	3. EXCESS PROFITS CREDIT (Item 3, Schedule C).	4. BALANCE SUBJECT TO TAX.	5. RATE.	6. AMOUNT OF TAX.
1. Net income, not in excess of 20% of invested capital.				20%	
2. Balance of net income.				40%	
3. Totals computed at 1921 rates under Section 301(a).					
4. Excess Profits Tax at 1921 rates, if computed under Section 302, 303, 304(c) or 337 of the Revenue Act of 1921 (see page 2 of Instructions, paragraph 14).					
5. Net income (Item 27, Schedule A).					
6. Less: Taxable interest on obligations of the United States (Item 5, Schedule A).					
7. Excess profits tax (Item 3 or 4, whichever is smaller, in column 6, Schedule D), or					
8. Profits taxes (first income from Government contract prior to January 1, 1922, exceeds \$100,000 (then 16, Form 1120A).					
9. Exemption \$2,000, for domestic corporation having a net income of less than \$25,000.					
10. Balance (Item 5, less Items 6, 7, and 9, or Items 6, 8, and 9).					
11. Income tax at 1921 rates (10% of Item 10).					
12. If the net income of a domestic corporation is less than \$25,000, enter amount in excess of \$25,000.					
13. Total tax for entire period computed at 1921 rates (Item 3 or 4 the lesser, or 8, plus Items 11 and 12).					
20. Total tax for fiscal year beginning in 1921 and ending in 1922 (Item 21 plus Item 22).					
21. Less: Income and profits taxes paid to foreign countries or possessions of the United States (attach Form 1118).					
22. Taxes paid at the source (see Section 237 of the Revenue Act of 1921).					
23. Balance of tax due (Item 23 minus Items 24 and 25).					

An amended return must be plainly marked "Amended."

Checks and drafts will be accepted only if payable at par.

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## QUESTIONS.

## KIND OF BUSINESS.

1. By means of the key letters given below, identify the corporation's main income-producing activity with one of the general classes, and follow this by a special description of the business sufficient to give the information called for under each general class.

A.—Agriculture and related industries, including mining, logging, etc. harvesting, etc., and also the raising of such property. State the product or products. B.—Mining and quarrying, including use of oil wells, and also the raising of such property. State the product or products. C.—Manufacturing. State the product and also the material if not implied by the name of the product. D.—Construction—construction, buildings, bridges, railroads, etc., etc., also equipping and installing same with systems, pipes, or machinery, without their manufacture. State nature of structures built, materials used, or kind of installations. E.—Transportation—land, water, local, etc. State the kind and special nature of transportation. F.—Public utilities—gas (natural, coal, or water), electric light or power (hydro or steam generated), heating (steam or hot water), telephone, waterworks or power. G.—Storage—without trading or profit from sales—(elevators, warehouses, stock yards, etc.) H.—Retail trade. I.—Leasing—transportation or utilities. J.—State kind of property. K.—Trading in goods bought and not produced by the trading concern. State manner of trade, whether wholesale, retail, or commission, and product handled. Sales with storage with profit primarily from sales. L.—Service—domestic, including hotels, restaurants, etc., amusements, other professional, personal, or technical service. M.—Finance, including banking, real estate, insurance. N.—Concern not falling in above classes (a) because of combining several of them with no predominant business, or (b) for other reasons.

2. Concerns whose business involves activity falling in two or more of the above general classes, where the same product is concerned, should report business as identified with but one of the above general classes; for example, concern in A or B which also transport and market their own product exclusively or mainly, should still be identified with classes A or B, concern in C (manufacturing) which owns or controls their own material supply, in A or B and which also transport, sell, or install their own product exclusively or mainly, should be identified with manufacturing, concern in J may control or own source of supply of material used exclusively or mainly in their construction work; concern in E or F may own or control the source of their material or power; concern in F may transport or store their own merchandise, but its production would identify them with A, B, or C.

3. Answer:

(a) General class (use key letter designation).

(b) Main income-producing business (give specifically the information called for under each key letter, also whether acting as principal, or as agent or commission; state if inactive or in liquidation).

## OTHER CORPORATIONS IN SAME BUSINESS.

4. Enter on the following lines the names and addresses of five representative corporations in your locality or section of the country engaged in the same kind of business:

## INCORPORATION.

5. Date of incorporation \_\_\_\_\_

6. Under the laws of what State or country \_\_\_\_\_

## REORGANIZATION AND ACQUISITION OF MIXED AGGREGATES OF ASSETS.

7. Has the corporation, or any of its predecessors, been reorganized, or has it, or any of its predecessors, taken over a going business or acquired a mixed aggregate of tangible and intangible property, and paid for such property in whole or in part with stock or other securities since the close of the preceding taxable period?

8. If so, furnish a brief narrative history of the business and submit a statement showing:

- The name of the concern taken over (or from which the property was acquired);
  - The nature of the assets and liabilities so acquired;
  - The total par value of the stock issued therefor;
  - The value at which each class of assets was carried on the books of the concern from which acquired (submit a balance sheet of the predecessor concern as at the date of acquisition or at the close of its last accounting period prior thereto);
  - The value at which the assets were carried on the books of the corporation making this return, and full details of any adjustments subsequently made pertaining thereto and the basis on which such valuation was made.
9. If patents, copyrights, secret processes or formulae, good will, trade-marks, trade brands, franchises, or other intangible property were acquired, state the basis on which their value was determined and how they were paid for.
10. If at the time of any purchase or reorganization as contemplated in question 7, any property was entered on the books of the recognized concern or any vendee predecessor at a value in excess of that at which it was carried on the books of the vendor concern, state the basis on which the valuation was made.

## AFFILIATIONS WITH OTHER CORPORATIONS (TO BE ANSWERED BY EVERY CORPORATION).

11. Does the corporation own directly or control through closely affiliated interests or by a nominee or nominees over 70 per cent of the outstanding voting capital stock of another corporation or of other corporations?

12. Is over 70 per cent of your outstanding voting capital stock owned by another corporation or by two or more corporations that are affiliated?

13. Is over 70 per cent of your outstanding voting capital stock as well as over 70 per cent of the outstanding voting capital stock of another corporation or of other corporations owned or controlled by the same individual or partnership or by the same individuals or partnerships?

## SCHEDULE K.—BALANCE SHEETS.

Attach hereto balance sheets as at the beginning and end of the taxable period (preferably in parallel columns), showing as nearly as practicable the details called for below. (These balance sheets should be prepared from the books and should be in agreement therewith, or any difference should be reconciled, and if this is a consolidated return, balance sheets should be furnished in accordance with paragraph 7 of page 1 of Instructions.)

ASSETS	ASSETS—Continued.	ASSETS—Continued.	LIABILITIES
Cash (including cash in bank and on hand, certificates of deposit, etc.).	Investments—continued.	Fixed assets—continued.	Notes payable:
Trade accounts (before deducting reserves for losses).	Foreign.	Less reserves for depreciation (show separately and specify applicable to each kind of asset).	To officers and stockholders.
Notes receivable from customers.	Loans and advances:		To others (including bank loans).
Other accounts and notes receivable (to be classified).	Transfers to and from employees.		Trusts.
Intangibles:	To officers.		Other.
Goodwill.	Disputed charges (future operations to be detailed).		Accrued expenses not reserved, the charges creating which are allowable deductions from income (to be detailed).
Work in progress.	Fixed assets:		Reserve, the charges creating which are not allowable deductions from income.
Finished products.	Land.		Reserve for losses on notes and accounts receivable (to be detailed).
Supplies.	Buildings.		Other reserves (to be detailed).
Investments:	Tools, and minor equipment.		Capital stock (unpaid) (to be classified).
U. S. bonds and obligations (each item to be stated separately).	Power equipment.		Surplus and undivided profits.
U. S. bonds (municipal, State, etc.).	Other furniture.		
Other.	Other (state character).		

\* Reserve for depreciation may be deducted from the respective asset accounts or itemized on the liability side of the balance sheet.

All corporations engaged in an interstate and intrastate trade or business and reporting to the Interstate Commerce Commission and to any national, State, municipal, or other public officer, may submit in lieu of above form, copies of their balance sheets prescribed by said Commission or State and municipal authorities, as at the beginning and end of the taxable period.

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## INSTRUCTIONS FOR CORPORATION RETURN.

## LIABILITY FOR FILING RETURNS.

1. **Corporations generally.**—Every domestic or resident corporation, joint-stock company, association, or insurance company not specifically exempted by Section 231 of the Revenue Act of 1921, whether or not having any net income, must file a return.

A corporation having a net income of less than \$3,000 for the taxable period need not fill in the schedule pertaining to excess profits tax, but if the net income is \$3,000 or more, it is subject to the excess profits tax and must file a complete return on this form.

2. **Government Contracts.**—In addition thereto, if net income in excess of \$10,000 was derived during the calendar year 1921 from a Government contract, Form 1120S must be secured from the Collector of Internal Revenue for your district and filed as a part of this return.

3. **Corporations in Possessions of the United States.**—Domestic corporations within the possessions of the United States (except the Virgin Islands) may report as gross income only gross income from sources within the United States, provided, (a) 80 per cent or more of the total gross income for the three-year period immediately preceding the close of the taxable year (or such part thereof as may be applicable) was derived from sources within a possession of the United States; and (b) 50 per cent or more of the total gross income for such three-year period or applicable part thereof was derived from the active conduct of a trade or business within a possession of the United States.

A corporation entitled to the above benefits, however, is not entitled to the specific exemption of \$3,000 in computing the excess profits tax. (See Sections 262 and 312, Revenue Act of 1921.)

4. **Foreign Corporations.**—A foreign corporation subject to the law, regardless of the amount of its net income, is required to file a return with the Collector in whose district is located its principal office or agency through which it transacts its business in the United States. If it has no office or agency in the United States, the return should be filed with the Collector of Internal Revenue, Baltimore, Maryland. The net income should be computed in accordance with Section 217 of the Revenue Act of 1921.

5. **Life Insurance Companies.**—A life insurance company, as defined by Section 242 of the Act, shall file its return on Form 1120L.

6. **Personal Service Corporations.**—Personal service corporations must file a return on Form 1065 B.

## CONSOLIDATED RETURNS.

7. The parent or principal reporting company of affiliated corporations as defined in Section 240 of the Act must file a consolidated return on this form with the Collector of the district in which its principal office is located and attach thereto a schedule showing the names and addresses of all affiliated corporations in the group, and of the tax is apportioned among these corporations, the amount allocated to each. (See paragraph 9, below.) Each of the other affiliated corporations shall file Form 1122 in the office of the Collector of its district.

Consolidated invested capital must be computed as at the beginning of the taxable period of the parent or principal reporting company and consolidated income must be computed on the basis of its taxable period.

All supplementary and supporting schedules should be prepared in columnar form, one column being provided for each corporation included in the consolidation, one column for a total of like items before adjustments are made, one column for intercompany eliminations and adjustments, and one column for a total of like items after giving effect to the eliminations and adjustments. The items included in the column for eliminations and adjustments should be symbolized so as to readily identify contra items affected, and if necessary, in order to give a correct understanding of these entries, suitable explanations should be appended.

8. If one domestic corporation owns 95 per cent or more of the outstanding voting stock of another, or if 95 per cent or more of the outstanding voting stock of two or more domestic corporations is owned by the same individual or individuals, partnership or partnerships, in substantially the same proportion, a consolidated return must be filed by such corporations. If the ownership is less than 95 per cent of the outstanding voting stock, but exceeds 70 per cent, the parent or principal corporation of any group of affiliated corporations must furnish the information called for in questions 11 to 14, page 3 of the return. Whenever the fiscal year of one or more subsidiary or other affiliated corporations differs from the fiscal year of the parent or principal corporation, the Commissioner should be fully advised by the taxpayer in order that provision may be made for assessing the tax in respect of the period prior to the beginning of the fiscal year of the parent or principal corporation.

9. The Department prefers that the entire tax shown on a consolidated return be paid by the parent or principal reporting corporation, instead of being apportioned among the corporations composing the affiliated group.

If apportionment is made, each subsidiary or affiliated corporation should state on its Form 1122 the amount of income and profits taxes to be assessed against it for the taxable period.

## PERIOD COVERED.

10. The taxable period is the fiscal year ending on the last day of any month other than December in the calendar year 1922, and the net income shall be computed upon the basis of the corporation's annual accounting period in accordance with the method of keeping the books, unless such method does not clearly reflect the income.

11. In the case of a return for a period of less than one year, the net income shall be placed on an annual basis by multiplying the amount thereof by twelve and dividing by the number of months included in such period; and the tax shall be such part of a tax computed on such annual basis as the number of months in such period is of twelve months.

If the period for which the first or final return is made includes fractions of months, there shall be added to the number of complete months as many thirtieths of a month as there are days in the fractional parts of months.

11. If a corporation changes its accounting period, it shall as soon as possible give to the Collector for transmission to the Commissioner written notice of such change and of its reasons therefor. Upon approval by the Commissioner, the corporation shall thereafter make its returns upon the basis of the new accounting period. The accounting period established for the taxable year immediately preceding must be adhered to unless permission has been received from the Commissioner to make a change. See Sections 212(c) and 226, Revenue Act of 1921.

## TIME AND PLACE FOR FILING.

12. The return must be sent to the Collector of Internal Revenue for the district in which the corporation's principal office is located, so as to reach the Collector's office on or before the fifteenth day of the third month following the close of the taxable period. In the case of a foreign corporation not having any office or place of business in the United States the return shall be filed on or before the fifteenth day of the sixth month following the close of the taxable period.

13. The Collector is authorized to grant an extension of not more than thirty days for filing returns in cases of *absence or sickness*. In meritorious cases the Commissioner is authorized to grant a further extension.

## SIGNATURES AND VERIFICATION.

14. The return shall be sworn to by the president, vice president, or other principal officer and by the treasurer or assistant treasurer. The return of a foreign corporation having an agent in the United States shall be sworn to by such agent. If receivers, trustees in bankruptcy, or assignees are operating the property or business of the corporation, such receivers, trustees, or assignees shall execute the return for such corporation, under oath.

## PAYMENT OF TAXES.

15. The tax should be paid by sending or bringing with the return a check or money order drawn to the order of "Collector of Internal Revenue at (insert name of city and State)."

16. Do not send cash through the mail or pay it in person except at the office of the Collector.

17. The total tax may be paid at the time of filing the return or in four equal installments, as follows:

The first installment shall be paid at the time fixed by law for filing the return, the second installment shall be paid on the fifteenth day of the third month, the third installment on the fifteenth day of the sixth month, and the fourth installment on the fifteenth day of the ninth month after the time fixed by law for filing the return.

## PENALTIES.

## For Making False or Fraudulent Return.

18. Not exceeding \$10,000 or not exceeding one year's imprisonment, or both, in the discretion of the court, and, in addition, 50 per centum of the total tax evaded.

## For Failing to Make Return on Time.

19. Not more than \$1,000, and, in addition, 25 per centum of the total amount of the tax.

## For Failing to Pay Tax When Due or Understatement of Tax Through Negligence, etc.

20. Five per centum of the tax due but unpaid plus interest at the rate of 1 per centum per month during the period in which it remains unpaid.

## WORKING PAPERS.

21. Every corporation should preserve, available for inspection by a revenue officer, working papers showing—

(a) The balance in each account on the corporation's books that was used in preparing Schedule A.

(b) The amount deducted from each such balance on account of each class of nontaxable income, unallowable deductions, and other adjustments indicated in Schedule L, with a reference to the number of the item in Schedule L in which each amount so deducted was included.

(c) The remainder of each such balance, analyzed to show the amount included in each item of Schedule A, with a reference to the number of the item in Schedule A in which each such amount was included.

## INFORMATION AT THE SOURCE.

22. Every corporation making payments of salaries, wages, interest, rent, commissions, or other fixed or determinable income of \$1,000 or more during the calendar year, to any individual or partnership, is required to make a true and accurate return to the Commissioner of Internal Revenue, showing the amount of such payments and the name and address of the recipient. Forms 1095 and 1099, for reporting such information, will be furnished by any Collector of Internal Revenue. Such returns of information covering the calendar year 1922 must be forwarded to the Commissioner of Internal Revenue, Sorting Section, Washington, D. C., in time to be received not later than March 15, 1923.

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## INSTRUCTIONS REGARDING INCOME, CREDITS, COMPUTATION OF TAX, ETC.

## GROSS INCOME AND DEDUCTIONS.

1. Railroad corporations, banks, insurance companies, and other corporations required to submit statements of income to any national, State, municipal, or other public officer may submit instead of Schedule A a statement of income and expenses in the form in which submitted to such officer. In such cases the taxable net income will be reconciled by means of Schedule L with the net profit shown by the income and expense statement submitted, and should be entered as Item 27, Schedule A, page 1.

2. A life insurance company issuing life insurance and annuity contracts (including contracts of combined life, health, and accident insurance), as defined by Section 242 of the Revenue Act of 1921, shall file its tax return on Form 1120L, instead of Form 1120.

3. An insurance company (other than a company taxed under Section 245 of the Act) issuing policies covering life, health, and accident insurance combined in one policy issued on the weekly premium payment plan, continuing for life, and not subject to cancellation, shall file its return on this form, and report as a deduction in Schedule A12 subject to the approval of the Commissioner, such portion of the net addition (not required by law) made within the taxable period, prior to January 1, 1922, to reserve funds as may be required for the protection of the holders of such policies only.

4. An insurance company (other than a life insurance company) should report as a deduction in Schedule A12 of this form, (a) the net addition required by law to be made within the taxable period to reserve funds (including in the case of an assessment insurance company the actual deposit of same with State or Territorial officers pursuant to law as additions to guarantee or reserve funds), and (b) the sums other than dividends paid within the taxable period on policy and annuity contracts. After December 31, 1921, this paragraph applies only to mutual insurance companies other than life insurance companies.

5. A mutual marine insurance company should report as Item 3, Schedule A, of this form, the gross premiums collected and received, less amounts paid for reinsurance, and report as a deduction in Schedule A12 amounts paid to policyholders on account of premiums previously paid by them and interest paid upon such amounts between ascertainment and the payment thereof.

6. The receipts of a shipowners' mutual protection and indemnity association, not organized for profit, and no part of the net earnings of which inure to the benefit of any private stockholder or member, are exempt from taxation, but such association shall be subject as a corporation to the tax upon its net income from interest, dividends, and rents.

7. A mutual insurance company (including interinsurance and reciprocal underwriters, but not including a mutual life or mutual marine insurance company) requiring its members to make premium deposits to provide for losses and expenses, should report in Schedule A12 of this form the amount of premium deposits returned to its policyholders and the amount of premium deposits retained for the payment of losses, expenses, and reinsurance reserves (unless otherwise allowed in Schedule A).

8. Incidental repairs, which do not add to the value or appreciably prolong the life of property, are deductible as expenses (Item 14, Schedule A). Expenditures for new buildings, machinery, equipment, or for permanent improvement or betterments which increase the value of the property are chargeable to capital account. Expenditures for restoring or replacing property are not deductible under this or any other item of the return. Such expenditures are chargeable to capital account or to depreciation reserve, depending on the treatment of depreciation on the books of the taxpayer.

9. The amount of interest deductible in Item 15, Schedule A, is the amount of interest paid within the taxable period on the corporation's indebtedness, except on indebtedness incurred or continued to purchase or carry obligations or securities (other than obligations of the United States issued after September 24, 1917, and originally subscribed for by the corporation), the interest upon which is wholly exempt from taxation. (See Sections 234(c) 2 and 234(b) of the Revenue Act of 1921.)

10. The amount deductible on account of depreciation in Item 18, Schedule A, is an amount fairly measuring the portion of the investment in depreciable property by reason of exhaustion, wear and tear and obsolescence which is properly chargeable against the operations of the year. Such amount should be determined upon the basis of the original cost (not replacement cost) of the property, or if acquired prior to March 1, 1913, the fair market value on that date, and the probable number of years remaining of its useful life. The capital sum to be replaced should be charged off over the useful life of the property either in equal annual installments or in accordance with any other recognized trade practice, such as an apportionment over units of production. Whatever plan or method of apportionment is adopted must be reasonable and must have due regard to operating conditions during the taxable period. The method adopted should be described in the return. Stocks, bonds, and like securities are not subject to exhaustion, wear and tear within the meaning of the law.

11. If property is compulsorily or involuntarily converted into cash or its equivalent as result of (a) its destruction in whole or in part, (b) theft or seizure, or (c) an exercise of the power of reversion or condemnation, or the threat or imminence thereof; and if the taxpayer proceeds forthwith in good faith, under regulations prescribed by the Commissioner with the approval of the Secretary, to expand the proceeds of such conversion in the acquisition of other property of a character similar or related in service or use to the property so converted, or in the acquisition of 80 per centum or more of the stock or shares of a corporation owning such other property, or in the establishment of a replacement fund, then there shall be allowed as a deduction such portion of the gain derived as the portion of the proceeds so expended bears to the entire proceeds. The gross receipts and deductions claimed should be included in Schedule A23. (See Section 234(e) 14 of the Revenue Act of 1921.)

## CREDIT FOR INCOME AND PROFITS TAXES PAID FOR FOREIGN COUNTRIES OR POSSESSIONS OF THE UNITED STATES.

12. If a credit is claimed in Item 24, Schedule D, a copy of Form 1118, completely filled out and sworn to or affirmed, must be submitted with this return. If credit is sought for taxes actually paid, the form must have attached to it the receipts for each such tax payment. If credit is sought for taxes accrued, the form must have attached to it the return on which each such accrued tax was based.

13. When a credit is claimed for accrued taxes, the Commissioner may, as a condition precedent to the allowance of this credit, require the corporation to give a bond (Form 1119) with sureties satisfactory to and to be approved by him in such penal sum as he may require, conditioned for the payment by the taxpayer of any amount of taxes found due if the taxes when paid differ from the amount claimed in respect thereof.

## PROVISIONS AFFECTING COMPUTATION OF TAX.

14. Schedule R, "Computation of Tax," may be subject to one or more of the following provisions:

(a) Return for a fiscal year.—The tax on a return for a fiscal year ended in 1922 should be computed in accordance with Sections 206, 236(c), and 335(b) of the Revenue Act of 1921.

(b) Limitation on income tax.—If the net income reported as Item 8, Schedule D, is more than \$25,000 the tax imposed by Section 230 of the Revenue Act of 1921 on the amount of the net income shall not exceed the tax which would be payable if the \$25,000 credit were allowed, plus the amount of the net income in excess of \$25,000.

(c) Limitations on excess profits tax.—The maximum excess profits tax imposed shall in no case be more than 20 per cent of the net income in excess of \$1,000 and not in excess of \$50,000 plus 40 per cent of the net income in excess of \$50,000 (Section 302), unless net income amounting to more than \$10,000 was derived from a Government contract, when the tax on such income shall be assessed under Section 301(b), in which case the maximum excess and war profits tax imposed upon this proportion of the net income shall not be more than 30 per cent of the amount of net income in excess of \$1,000 and not in excess of \$20,000 plus 50 per cent of the amount of net income in excess of \$20,000. (See Section 302.)

(d) Tax of corporation whose income is derived in part from "Personal Service."—If part of the net income (not less than 30 per cent) is derived from a separate trade or business of the character of "personal service," the tax shall be computed in accordance with the provisions of Section 303 of the Act.

(e) Tax on corporation engaged in mining of gold.—If a corporation is engaged in the mining of gold, its excess profits tax shall be that proportion of Item 3, Schedule D, which the net income not derived from the mining of gold bears to the total net income. (See Section 304(e) of the Act.)

(f) Tax on profits from sale of mineral products.—In the case of a bona fide sale of mines, oil or gas wells, or any interest therein, where the principal value of the property has been demonstrated by prospecting or exploration and discovery work done by the taxpayer, the portion of the excess profits tax attributable to such sale shall not exceed 20 per cent of the selling price of such property or interest. (See Section 337 of the Act.)

The first step is to find the excess profits tax computed without regard to this provision; the second is to find of the tax thus computed such portion as the net income from the sale bears to the total net income. If this portion equals or does not exceed 20 per cent of the selling price, then no adjustment is permitted. Should such portion exceed 20 per cent of the selling price, the tax will be that portion of the excess profits tax which the net income not attributable to the sale bears to the total net income plus 20 per cent of the selling price of the mineral products.

15. Statement of basis of claims.—If a corporation claims the benefit of any of the provisions outlined in (d), (e), or (f), it should attach to the return a complete statement of the basis for such claim and a computation of the tax payable in the event that such claim is allowed. The amount of tax so computed should be entered in Schedule D.

## SPECIAL CASES.

16. Definition of special cases.—Section 327 of the Act provides that in the following cases the tax shall be determined as provided in Section 328:

(a) Where the Commissioner is unable to determine the invested capital as provided in Section 328.

(b) In the case of a foreign corporation or a corporation entitled to the benefits of Section 262 of the Revenue Act of 1921. (See paragraph 8, page 1 of Instructions.)

(c) Where a mixed aggregate of tangible property and intangible property has been paid in for stock or for stock and bonds and the Commissioner is unable satisfactorily to determine the respective values of the several classes of property at the time of payment, or to distinguish the classes of property paid in for stock and for bonds, respectively.

(d) Where, upon application by the corporation, the Commissioner finds and declares of record that the tax if determined without benefit of this section would, owing to abnormal conditions affecting the capital or income of the corporation, work upon the corporation an exceptional hardship evidenced by gross disproportion between the tax computed without benefit of this section and the tax computed by reference to the representative corporations specified in Section 328. This subdivision shall not apply to any case: (1) in which the tax (computed without benefit of this section) is high merely because the corporation earned within the taxable period a high rate of profit upon a normal investment, or (2) in which 50 per cent or more of the gross income of the corporation for the taxable period (computed under Section 233 of the Act) consisted of gains, profits, commissions, or other income derived on a cost-plus basis from a Government contract or contracts made between April 6, 1917, and November 11, 1918, both dates inclusive.

17. Treatment of special cases.—In the cases specified in Section 327 the tax will be specially determined under the provisions of Section 328. A corporation which comes within the provisions of subdivision (d) of Section 327 (paragraph 16, above) may make application for assessment under the provisions of Section 328, which application shall be attached to its return in the form of a statement setting forth in full: (a) The reasons why the tax should be so determined; (b) the facts upon which such reasons are based; (c) an exact description of each trade or business or important branch of a trade or business carried on by it; (d) a statement of the invested capital and net income for each year since the beginning of the prewar period; and (e) a statement showing the amount of gains, profits, commissions, or other income derived on a cost-plus basis from Government contracts made between April 6, 1917, and November 11, 1918, both dates inclusive, and showing the per cent which such income is of the total income of the corporation.

18. Returns in special cases.—Corporations other than foreign corporations making claim for assessment under Section 328 of the Act should answer all questions and file all schedules as far as possible and attach a statement explaining why it is impracticable to fill out the entire return.

## UNDISPUTED PROFITS TAXABLE TO STOCKHOLDERS.

19. If any corporation, however created or organized, is formed or availed of for the purpose of preventing the imposition of the surtax upon its stockholders or members through the medium of permitting gains and profits to accumulate instead of being divided or distributed, there shall be levied, collected and paid for each taxable year upon the net income of such corporation a tax equal to twenty-five per cent (25%) of the amount thereof, which shall be in addition to the tax imposed by Section 230, Revenue Act of 1921, and shall be computed, collected, and paid upon the same basis and in the same manner and subject to the same provisions of law, including penalties, as that tax. (See Section 220, Revenue Act of 1921.)

S-1120A

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**WAR-PROFITS AND EXCESS-PROFITS TAX REGULATIONS, ETC.—1922-1923.****REGULATIONS 62, PART II-B****Relating Specifically to the****WAR-PROFITS AND EXCESS-PROFITS TAX FOR 1921.***[Promulgated February 15, 1922.—Released for publication, March 1, 1922.]***CONTENTS****Always up-to-date. Paragraph references to all amendments.***[The section numbers refer to the statute and the article numbers to the regulations.]*

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**1101 Important Comment.**—Each Article of Regulations 62, Part II to (Excess-Profits Tax) printed on the pages immediately following is captioned prominently in bold-face type. Without exception the **1133** Articles of Regulations 62, referring specifically to the excess-profits tax law for 1921, that is, the 7-hundred (701), the 8-hundred (801) and the 9-hundred (901) series, are printed in regular numerical order. Thus any particular Article may be located without difficulty. The fact that there are missing Article numbers (as Art. 702 to 710) in the 7-, 8-, and 9-hundred series, indicates with certainty that on March 1, 1922, there were no Articles bearing such missing number designations. Attention is called to the purely supplementary **Bureau Rulings**, reproduced herein in full, as originally issued by the Government, on the white pages following immediately after the blue 1918 excess-profits tax index at page 400. *The reader is earnestly cautioned to read the foreword to these Bureau Rulings.*

**GENERAL DEFINITIONS.**

**1134 Art. 701. War-profits and excess-profits tax.**—The war-profits and 1000 excess-profits tax, like the income tax, is a tax upon net income. It applies only to corporations. The terms “taxable year,” “fiscal year,” “personal service corporation,” “paid or accrued,” and “dividends,” and in general all other terms used in connection with the income tax, have here the same meaning as provided for the purposes of the income tax. (See secs. 2, 200, and 201 [beginning at ¶1001 and at ¶8084].) For other terms see sections 310 and 325 and articles 771 and 811-818.

**IMPOSITION OF TAX**

**1135 Art. 711. Imposition of tax.**—The tax is imposed upon the net income 1011 attributable to the calendar year 1921, of every corporation, domestic or foreign, except life insurance companies, personal service corporations and certain other classes of corporations. (See sec. 304 of the statute and arts. 751-753.) Special provisions of the statute deal with corporations deriving net income from Government contracts (see sec. 2 [¶1003]), corporations partly partaking of the nature of personal service corporations (see sec. 303), corporations engaged in the mining of gold (see sec. 304), foreign and abnormal corporations (see sec. 327), reorganized and consolidated corporations (see section 331), corporations making their returns upon the basis of a fiscal year (see sec. 335), and corporations which have sold mines or oil or gas wells (see sec. 337). For the requirements as to rendering returns see section 336.

**1136** Art. 712.\* **Computation of tax for 1921.**—For the calendar year  
 1011 1921, (a) if the net income, as defined in section 320 of the statute, is not in excess of 20 per cent of the invested capital, as defined in section 326, then under the first bracket the tax payable is 20 per cent of the amount of the net income in excess of the excess profits credit, as defined in section 312, and the second bracket is not applicable. (b) If the net income is in excess of 20 per cent of the invested capital, then under the first bracket the tax is 20 per cent of the excess of an amount of net income equal to 20 per cent of the invested capital over the excess profits credit, and under the second bracket the tax is 40 per cent of the amount of the remaining net income less any excess profits credit not exhausted under the first bracket. The sum of the taxes computed under the two brackets is the tax payable. But see the following article and section 302.

*\*Was Art. 713 of Reg. 45. Therefore, for Supplementary Bulletin Rulings bearing on this Article, refer to Art. 713 in the Supplementary Bulletin Rulings.*

**1137** Art. 713.\* **Computation of tax on income from Government con-**  
 1014 **tracts.**—In the case of a corporation which derives in the calendar year 1921 a net income of more than \$10,000 from any Government contracts made after April 5, 1917, and before November 12, 1918, the tax shall be the sum of the following: (1) Such a proportion of a tax computed at the rates for 1918, specified in subdivision (a) of section 301 of the Revenue Act of 1918, as the portion of the net income attributable to the Government contracts bears to the entire net income, and (2) such a proportion of a tax computed at the rates for 1921, specified in section 301(a) of the Revenue Act of 1921, as the amount of the remaining net income bears to the entire net income. In computing the tax under (1), however, the excess profits credit and the war profits credit which would have been applicable to the calendar year 1921 under the revenue act of 1918, if it had been continued in force, shall be used. [For example of computation of tax see ¶1144.] But see section 302 of the statute. The part of the net income attributable to such Government contracts shall be determined in accordance with the following article. (See also sec. 2 [Law ¶1003] and art. 1510.)

*\*Was Art. 714 of Reg. 45. Therefore, for Supplementary Bulletin Rulings bearing on this Article, refer to Art. 714 in the Supplementary Bulletin Rulings.*

**1138** Art. 714.\* **Allocation of net income to particular source.**—Whenever  
 1017 it is necessary to determine the portion of the net income derived from or attributable to a particular source, the corporation shall allocate to the gross income derived from such source, and to the gross income derived from each other source, the expenses, losses, and other deductions properly appertaining thereto, and shall apply any general expenses, losses, and deductions (which can not properly be directly apportioned) against gross income from the respective sources upon a reasonable basis that will assign to each source a proper proportion of such deductions. The gross income derived from a particular source, less the deductions properly appertaining thereto and less its proportion of any general deductions, shall be the net income derived from such source. The corporation shall submit with its return a statement fully explaining the manner in which such expenses, losses, and deductions were allocated or distributed.

*\*Was Art. 715 of Reg. 45. Therefore, for Supplementary Bulletin Rulings bearing on this Article, refer to Art. 715 in the Supplementary Bulletin Rulings.*



**WAR-PROFITS AND EXCESS-PROFITS TAX REGULATIONS, ETC.—1922-1923.**

**1139 Art. 715.\* Illustration of computation of tax.**—A corporation has an invested capital for calendar year 1921 of \$110,000 and a net income of \$40,000.

**1140** The excess profits credit is a specific exemption of \$3,000, plus 8 per cent of the invested capital for taxable year (i. e., 8 per cent of \$110,000) or \$8,800, making a total of \$11,800. (See sec. 312 of the statute and art. 791.)

**1141 First bracket:** The amount or portion of the net income (\$40,000) in excess of the excess profits credit (\$11,800) and not in excess of 20 per cent of the invested capital (i. e., 20 per cent of \$110,000) or \$22,000, is \$10,200. The tax computed under this bracket is 20 per cent of this amount (i. e., 20 per cent of \$10,200) or \$2,040.

**1142 Second bracket:** The amount or portion of the net income (\$40,000) in excess of 20 per cent of the invested capital (i. e., 20 per cent of \$110,000) is \$18,000. The tax computed under this bracket is 40 per cent of this amount (i. e., 40 per cent of \$18,000) or \$7,200.

**1143 Total tax:** The total excess profits tax is the sum of the taxes computed under the two brackets (i. e., \$2,040 plus \$7,200) or \$9,240.

*\*Was Art. 716 of Reg. 45. Therefore, for Supplementary Bulletin Rulings bearing on this Article, refer to Art. 716 in the Supplementary Bulletin Rulings.*

**1144 Art. 716.\* Illustration of computation where net income derived from**  
**1016 Government contract.**—A corporation has an average prewar invested capital of \$60,000; an average prewar net income of \$10,000; a net income for calendar year 1921 of \$40,000 which includes \$15,000 of net income from Government contracts and an invested capital for calendar year 1921 of \$110,000. The tax for calendar year 1921 will be the sum of the amounts computed under clauses (1) and (2) of section 301(b) of the statute.

**1145** (1) Under clause (1) the excess profits credit is \$11,800, the same as under clause (2). The war profits credit is a specific exemption of \$3,000, plus the average prewar net income, or \$10,000, plus 10 per cent of \$50,000 (the difference in invested capital) or \$5,000, making a total war profits credit of \$18,000.

**1146 First bracket:** The amount or portion of the net income (\$40,000) in excess of the excess profits credit (\$11,800) and not in excess of 20 per cent of the invested capital (i. e., 20 per cent of \$110,000) or \$22,000, is \$10,200. The tax computed under this bracket is 30 per cent of this amount (i. e., 30 per cent of \$10,200) or \$3,060.

**1147 Second bracket:** The amount or portion of the net income (\$40,000) in excess of 20 per cent of the invested capital (i. e., 20 per cent of \$110,000) or \$22,000, is \$18,000. The tax computed under this bracket is 65 per cent of this amount (65 per cent of \$18,000) or \$11,700.

**1148 Third bracket:** Eighty per cent of the amount in excess of the war profits credit (i. e., 80 per cent of the amount by which \$40,000 exceeds \$18,000, or \$22,000) is \$17,600. The amount of the tax computed under the first and second brackets (\$3,060 plus \$11,700) is \$14,760. The tax computed under this bracket is the amount by which \$17,600 exceeds \$14,760, or \$2,840.

**1149** The portion of the tax computed under clause (1) is the same proportion of the total amount computed under the above brackets at the rates for 1918 (i. e., \$3,060 plus \$11,700 plus \$2,840) or \$17,600, as the part of the net income attributable to Government contracts (\$15,000) is

of the entire net income (\$40,000). This portion of the tax is therefore three-eighths of \$17,600, or \$6,600.

**1150** (2) The portion of the tax computed under clause (2) is the same proportion of the total amount computed at the rates for 1921, or \$9,240 (for the details see illustration for 1921 under article 715) as the part of the net income attributable to Government contracts (\$25,000) is of the entire net income (\$40,000). This portion of the tax is therefore five-eighths of \$9,240, or \$5,775.

**1151** (3) The total tax for the year 1921 is the sum of the amounts computed under paragraphs (1) and (2) above (\$6,600 plus \$5,775) or \$12,375.

*\*Was Art. 719 of Reg. 45. Therefore, for Supplementary Bulletin Rulings bearing on this Article, refer to Art. 719 in the Supplementary Bulletin Rulings.*

**1152** Art. 717.\* Illustration of computation where excess profits credit not exhausted under first bracket.—A corporation has an invested capital for calendar year 1921 of \$20,000 and a net income of \$7,000.

**1153** The excess profits credit is a specific exemption of \$3,000 plus 8 per cent of the invested capital (i. e., 8 per cent of \$20,000) or \$1,600, a total of \$4,600.

**1154** *First bracket:* The excess profits credit (\$4,600) exceeds 20 per cent of the invested capital (20 per cent of \$20,000) or \$4,000, and there is no amount taxable under this bracket.

**1155** *Second bracket:* The portion of the net income (\$7,000) in excess of 20 per cent of the invested capital (20 per cent of \$20,000) or \$4,000, is \$3,000. In this case, however, the full amount of the excess profits credit could not be allowed under the first bracket, so that the \$3,000 which would ordinarily be taxable under this bracket is reduced by the amount of the excess profits credit not allowed under the first bracket (\$600), leaving only \$2,400 taxable under this bracket. The tax computed under this bracket is 40 per cent of this amount (i. e., 40 per cent of \$2,400) or \$960.

**1156** *Total tax:* The total excess profits tax for calendar year 1921 would be the sum of the taxes computed under the two brackets (i. e., nothing plus \$960), or \$960, were it not that section 302 provides that the maximum tax shall not, in this case, exceed \$800. (See arts. 731-733.) The total excess profits tax for calendar year 1921 is therefore \$800.

*\*Was Art. 718 of Reg. 45. Therefore, for Supplementary Bulletin Rulings bearing on this Article, refer to Art. 718 in the Supplementary Bulletin Rulings.*

**1157** Art. 718.\* Illustration of computation where return is for period of less than 12 months.—A corporation which has reported on the basis of the fiscal year ending March 31, 1921, later changes to a calendar year basis and files a return covering the 9 months from April 1, 1921, to December 31, 1921. It has an invested capital for the nine months, ending December 31, 1921, of \$120,000, and a net income for such period of \$50,000. The excess-profits credit is computed by adding the specific exemption of \$3,000 to 8 per cent of the full invested capital of \$120,000, or \$9,600, a total of \$12,600. The income is placed on an annual basis in accordance with section 226(c) by multiplying the amount thereof, \$50,000, by 12 and dividing by 9, or \$66,666.67.

*First bracket.*—The amount or portion of the net income (\$66,666.67) in excess of the excess-profits credit (\$12,600) and not in excess of 20 per cent



of the invested capital (i. e., 20 per cent of \$120,000), or \$24,000, is \$11,400. The tax computed under this bracket is 20 per cent of this amount (i. e., 20 per cent of \$11,400), or \$2,280.

*Second bracket.*—The amount or portion of the net income (\$66,666.67) in excess of 20 per cent of the invested capital (i. e., 20 per cent of \$120,000), or \$24,000, is \$42,666.67. The tax computed under this bracket is 40 per cent of this amount (i. e., 40 per cent of \$42,666.67), or \$17,066.67.

*Total tax.*—Nine-twelfths of the sum of the taxes computed under the two brackets (i. e., \$2,280 plus \$17,066.67), or \$14,510.

*\*Was Art. 720 of Reg. 45. Therefore, for Supplementary Bulletin Rulings bearing on this Article, refer to Art. 720 in the Supplementary Bulletin Rulings.*

### **LIMITATION OF TAX.**

**1158 Art. 731. Limitation of tax.**—In any case where the net income is  
 1019 at least \$20,000 the computation under section 302 of the statute may be shortened as follows: The tax imposed by subdivision (a) of section 301 shall not exceed \$3,400, plus 40 per cent of the amount of the net income in excess of \$20,000.

**1159** Where the net income is less than \$20,000 the tax shall not exceed 20 per cent of the amount of the net income in excess of \$3,000.

**1160** Where net income in excess of \$10,000 is derived during the calendar year 1921 from Government war contracts, the limitations imposed in such a case by the Revenue Act of 1918 are continued in effect by the present statute.

**1161 Art. 732. Limitation when return for fractional part of year.**—When a return is rendered for a fractional part of a year, the limitation shall be computed in the same manner as if the period covered by the return were a full taxable year.

**1162 Art. 733. Illustration of computation of limitation of tax.**—A corporation has an invested capital for calendar year 1921 of \$20,000 and a net income of \$9,000. The excess profits tax computed under section 301 (a) of the statute would be \$1,760. Section 302 provides, however, that the tax under section 301(a) shall not be more than 20 per cent of the net income in excess of \$3,000 and not in excess of \$20,000. In this case the tax must not exceed 20 per cent of \$6,000 (i. e., 20 per cent of the net income in excess of \$3,000) or \$1,200. The tax under section 301(a), amounting to \$1,760, will accordingly be reduced to \$1,200.

### **TAX WHEN PARTLY PERSONAL SERVICE BUSINESS.**

**1163 Art. 741. Apportionment of invested capital and net income.**—For  
 1020 the purpose of determining whether or not a corporation partly partaking of the nature of a personal service corporation is within the scope of section 303 of the statute and also for the purpose of establishing the basis for the computation of the tax, the corporation shall apportion or allocate its invested capital between each trade or business or branch thereof as nearly as may be in accordance with the actual facts, and shall submit with its return an explanatory statement setting forth the manner in which the apportionment of the invested capital employed in the production of each part of its net income has been determined. There must be assigned to any

personal service trade or business or branch thereof an amount of invested capital at least as great as that which would ordinarily be employed by a personal service corporation of similar size and standing for the payment of salaries and office expenses, maintenance of library and equipment, credit advances to clients, etc. For the method of determining the portion of the net income derived from each trade or business or branch thereof see article 714. For the definition of "personal service corporation" see [Law ¶1002 and] articles 1523-1532.

**1164 Art. 742. Computation of tax upon net income.**—(1) The tax upon the nonpersonal service part of the net income is computed upon the basis of (a) such part of the entire invested capital for the taxable year as has been employed in the production of the net income upon which the tax is being computed; and (b) the same proportion of the specific exemption as the proportion which the part of the net income upon which the tax is being computed is of the entire net income.

**1165** (2) The tax upon the personal service part of the net income is the same percentage thereof as the tax computed under (1) is of the nonpersonal service part of the net income. The tax under this paragraph shall in no case be less than 20 per cent of the personal service part of the entire net income, unless the tax upon the entire net income if computed in the ordinary way would be less than 20 per cent of such entire net income. In that event, and in any case in which the amount of the total tax as computed under this article is the same as or greater than the tax as computed in the ordinary way, the tax shall be computed under section 301 of the statute. (See sec. 302 and arts. 711-718 and 731-733.)

**1166 Art. 743. Illustration of computation of tax where partly personal service business.**—A corporation is engaged in contracting and construction work (a nonpersonal service business in which the employment of capital is necessary) and also renders consulting engineering service (a personal service business which, if constituting its sole business, would bring it within the class of personal service corporations). It has an invested capital for 1921 of \$100,000 (of which \$81,000 is used in contracting and \$19,000 in engineering); and a net income for 1921 of \$90,000 (of which \$30,000 is derived from contracting and \$60,000 from engineering).

**1167** (1) In computing the tax upon the first or nonpersonal service part of the net income (i. e., \$30,000 derived from contracting) the specific exemption is \$1,000 (i. e., the same proportion of \$3,000 which \$30,000 is of the entire net income of \$90,000). The excess profits credit is a specific exemption of \$1,000, plus 8 per cent of the invested capital used in contracting (i. e., 8 per cent of \$81,000) or \$6,480, a total of \$7,480.

**1168 First bracket:** The amount of the net income derived from contracting (\$30,000) in excess of the excess profits credit (\$7,480) and not in excess of 20 per cent of the invested capital (i. e., 20 per cent of \$81,000) or \$16,200, is \$8,720. The tax under this bracket is 20 per cent of this amount (i. e., 20 per cent of \$8,720) or \$1,744.

**1169 Second bracket:** The amount of the net income derived from contracting (\$30,000) in excess of 20 per cent of the invested capital used in contracting (i. e., 20 per cent of \$81,000) or \$16,200 is \$13,800. The tax computed under this bracket is 40 per cent of this amount (40 per cent of \$13,800) or \$5,520.



**1170** *Tax:* The tax upon the first portion of the net income (i. e., \$30,000, derived from contracting) is the sum of the taxes computed under the two brackets (i. e., \$1,744 plus \$5,520) or \$7,264. This is 24.214 per cent of \$30,000, the net income from contracting.

**1171** (2) The tax upon the second or personal service part of the net income (i. e., \$60,000, derived from engineering) is the same percentage of such part of the net income (i. e., 24.214 per cent of \$60,000) or \$14,528.

**1172** (3) The total tax is the sum of \$7,264 (the tax upon the first part of the net income derived from contracting) and \$14,528 (the tax upon the second part of the net income derived from engineering) or \$21,792.

### EXEMPTIONS.

**1173** **Art. 751. Corporations exempt from tax.**—A corporation whose net income for a full taxable year of twelve months is less than \$3,000 is exempt from the tax. [For return requirements in such cases see ¶851.] If the taxable period is less than twelve months the corporation is exempt from the tax if its net income for the period is less than the same proportion of \$3,000 as the number of months in the period is of twelve months, any fractional part of a month being counted as the number of days in such part of a month divided by 30. Life insurance companies are not subject to the tax. (See art. 661.) Certain classes of corporations, including personal service corporations, named in section 231 of the statute [Law ¶1059] are also exempt. (See arts. 511-522.)

**1174** **Art. 752. Net income exempt from tax.**—If a corporation is engaged in the mining of gold, the portion of its net income derived from that source is exempt from the tax imposed by this title and also from the tax imposed by Title II of the Revenue Act of 1917. The tax on the remaining portion of its net income is the proportion of the tax that would have been payable had the entire net income been derived from other sources than the mining of gold, which such remaining portion of the net income bears to the entire net income. For the method of determining the net income derived from the mining of gold see article 714.

**1175** **Art. 753. Illustration of computation of tax where net income is from gold mining.**—In the case of the corporation used as an illustration in article 715, let it be assumed that it is engaged in the mining both of gold and other rare metals; that the Commissioner finds under article 714 that \$25,000 of its gross income is properly attributable to the mining of gold; and that \$15,000 of the deductions allowed are properly applicable to the gross income from that source. The portion of the net income attributable to the mining of gold and exempt from tax would be \$10,000. The remaining portion of the net income is \$30,000, and the tax thereon is the same proportion of the tax computed on the entire net income without the benefit of the exemption (i. e., a tax of \$9,240) which the remaining portion of the net income (\$30,000) bears to the entire net income (\$40,000). The tax will therefore be three-fourths of the tax of \$9,240 computed without benefit of the exemption, or \$6,930.

### APPORTIONMENT OF SPECIFIC EXEMPTION

**1176** **Art. 761. Apportionment of specific exemption.**—Full effect is given to section 305 by placing the income on an annual basis as provided in section 226(c). See articles 718, 855, and 856.

### EXCESS-PROFITS CREDIT

**1177** Art. 791. Excess profits credit.—The excess profits credit consists of  
1025 the specific exemption of \$3,000 plus an amount equal to 8 per cent  
of the invested capital for the taxable year. In the case of affiliated  
corporations making a consolidated return only one specific exemption of  
\$3,000 is allowed. (See also secs. 240 [law ¶1078] and 305 of the statute and  
arts. 716-718, 743, and 761.)

### NET INCOME

**1178** Art. 801. Net income.—The net income of a corporation for the  
1027 purpose of the imposition of the excess profits tax is the same net  
income [see ¶1089] as determined for the purpose of the income tax.

### TERMS RELATING TO INVESTED CAPITAL

**1179** Art. 811. Intangible and tangible property.—Intangible property  
1029 includes patents and good will and other like property. Tangible  
1040 property includes all property other than intangible property. Most  
contracts are intangible property, and in the absence of a specific  
ruling by the commissioner to the contrary should be so regarded for the  
purpose of making returns. A contract may be treated as tangible property  
only after the submission of a full statement as to its exact nature, showing  
to the satisfaction of the commissioner that it relates to rights in tangible  
property to such an extent that its value arises chiefly therefrom. Associated  
Press, United Press, and similar franchises, and subscription lists and mailing  
lists are intangible property.

**1180** Art. 812. Borrowed capital: securities.—Any interest in a corpora-  
1031 tion represented by bonds, debentures, or other securities, by what-  
1041 ever name called, if with respect to the payment of either interest  
or principal it ranks with or prior to the interest of the general  
creditors, is borrowed capital and can not be included in computing invested  
capital.

**1181** Art. 813. Borrowed capital: amounts left in business.—Whether a  
1031 given amount paid into or left in the business of a corporation con-  
1041 stitutes borrowed capital or paid-in surplus is a question of  
fact. Thus, indebtedness to stockholders canceled and left in  
the business would ordinarily constitute paid-in surplus, while amounts  
left in the business representing salaries of officers in excess of their actual  
withdrawals, or deposit accounts in favor of partners in a partnership suc-  
ceeded by the corporation, will be considered paid-in surplus or borrowed  
capital according to the facts of the particular case. The general principle  
is that if interest is paid or is to be paid on any such amount, or if the stock-  
holder's or officer's right to repayment of such amount ranks with or before  
that of the general creditors, the amount so left with the corporation must  
be considered as borrowed capital and be so treated in computing invested  
capital.

**1182** Art. 814. Borrowed capital: other illustrations.—Items such as  
1031 deposits or amounts due to other banks shown in the balance sheet  
1041 of a bank, unexpired subscriptions shown in the balance sheet of a  
publishing concern, etc., are deemed liabilities and can not be included  
in computing invested capital.



**1183 Art. 815. Inadmissible assets.**—Stocks, bonds, and other obligations  
 1032 (other than obligations of the United States), the dividends or interest from which are not required to be included in computing net income, are inadmissible assets even though no such dividends or interest have been actually paid or received during the taxable year. The failure to pay or to receive dividends or interest does not change the status of such securities as inadmissible assets. A corporation can not by including the income from inadmissible assets as taxable income create the right to have such assets considered admissible assets.

[For Federal Reserve Bank stock see ¶744. For War Finance Corporation bonds see ¶745.]

**1184 Art. 816. Inadmissible assets: Government bonds.**—Obligations of a  
 1032 State or Territory, or any municipal or other political subdivision thereof, of the District of Columbia, or of any possession of the United States, and Federal farm loan bonds, not being obligations of the United States within the meaning of the statute, are inadmissible assets. See sec. 213 (b) of the statute and arts. 74-85.

**1185 Art. 817. Inadmissible assets: partial exception.**—(a) Where the  
 1032 income derived from inadmissible assets consists in part of profit from the disposition thereof, or (b) where all or a part of the interest derived from such assets is in effect included in net income because the interest paid on indebtedness incurred or continued to purchase or carry such assets may not be deducted from gross income, in either case a corresponding part of the capital invested in such assets shall be deemed an admissible asset. This article applies separately to each issue or class of inadmissible securities held by a corporation. For example, it may hold A company stock costing \$100,000 and B company stock costing \$200,000. During the year it receives \$8,000 in dividends from A company and \$5,000 from B company, and on September 30 sells part of its B company stock at a profit of \$3,000. For the period from January 1 to September 30, \$75,000 of its holdings of B company stock become admissible. After September 30 its remaining holdings of B company stock are inadmissible, but the proceeds of the sale are admissible unless invested in inadmissibles. (See arts. 852 and 854.)

**1186 Art. 818. Admissible assets.**—Admissible assets include all assets  
 1033 other than inadmissible assets. Organization expenses and deferred charges against future income are admissible assets. For all purposes of computing invested capital admissible assets must be valued in accordance with the provisions of sections 326 and 331 of the statute and the articles thereunder. Thus, for example, intangible property paid in for stock or shares is an admissible asset, but it can not be valued at an amount in excess of that at which it may be included in computing invested capital under paragraphs (4) and (5) of section 326 (a).

### INVESTED CAPITAL

**1187 Art. 831. Meaning of invested capital.**—Invested capital within the  
 1035 meaning of the statute is the capital actually paid into the corporation by the stockholders, including the surplus and undivided profits, and is not based upon the present net worth of the assets, as shown by an appraisal or in any other manner. The basis or starting point in

the computation of invested capital is found in the amount of cash and other property paid in, the valuation at which such other property may be included being determined in accordance with the statute and the regulations. The computation does not stop, however, with such original entries or amounts, but also takes into account the surplus and undivided profits of prior years left in the business. The invested capital of a corporation includes, generally speaking, (a) the cash paid in for stock, (b) the tangible property paid in for stock, (c) the surplus and undivided profits, and (d) the intangible property paid in for stock (to a limited amount), less, however, the same proportion of such aggregate sum as the amount of inadmissible assets bears to the amount of the admissible assets and the inadmissible assets held during the taxable year. Invested capital does not include borrowed capital. (See sec. 325 of the statute and arts. 811-818.) The fair market value of the assets as of March 1, 1913, has no bearing on invested capital. (See sec. 202 and art. 1561.)

**1188 Art. 832. Cash paid in: bonus stock.**—Capital stock issued as a  
1036 bonus in connection with the sale of a corporation's bonds may not be included in invested capital unless the corporation proves to the satisfaction of the Commissioner that such stock bonus enabled the corporation to secure a higher price for the bonds than it could otherwise have secured. Wherever this fact is established such stock shall be included in computing invested capital to the extent of the difference between the selling price of the bonds and the price at which they could have been sold if issued without such stock bonus. The excess of the face value of such bonds over the price at which they could have been sold if issued without the stock bonus is deemed discount and is subject to amortization. (See art. 39.)

**1189 Art. 833. Tangible property paid in: evidences of indebtedness.**—  
1037 Enforcible notes or other evidences of indebtedness, either interest-bearing or noninterest-bearing, of the subscriber received by a corporation upon a subscription for stock may be considered as tangible property in computing its invested capital to the extent of the actual cash value of such notes or other evidences of indebtedness at the time when paid in, but only (a) if such notes or evidences of indebtedness could under the laws of the jurisdiction in which the corporation was organized legally be received in payment for stock, and (b) if they were actually received by the corporation as absolute, and not as conditional, payment in whole or in part of the stock subscription.

**1190 Art. 834. Tangible property paid in: inadmissible assets.**—Stocks,  
1038 bonds, and other obligations (other than obligations of the United States), the dividends or interest from which are not included in computing net income, when bona fide paid in for stock or shares, may like other tangible property be included in computing the invested capital of the corporation at their actual cash value when paid in. For the purpose of the reduction required in articles 852 and 854, however, account must be taken of such assets in the same manner as of any other inadmissible assets.

**1191 Art. 835. Tangible property paid in: mixture of tangible and intan-**  
1037 **gible property.**—Where stock or shares and bonds or other obligations have been issued for a mixed aggregate of tangible and intangible property, it will be presumed in the absence of satisfactory evidence to the



contrary that the bonds were issued for tangible property and that the stock was issued for the balance of the tangible property, if any, and for the intangible property. Where stock or shares have been issued for a mixed aggregate of tangible and intangible property and certain liabilities have been assumed in connection with the transaction, it will be presumed that such liabilities are to be charged against the tangible property and the intangible property in the order named, unless it is shown by evidence satisfactory to the Commissioner that this presumption is not in accordance with the facts. (See further sec. 327 (c) of the statute.)

**1192 Art. 836. Tangible property paid in: value in excess of par value of**  
1037 **stock.**—[For this Article 836 amended see ¶1265.] Evidence offered to support a claim for a paid-in surplus must be as of the date of the payment, and may consist among other things of (a) an appraisal of the property by disinterested authorities made on or about the date of the transaction; (b) certification of the assessed value in the case of real estate; and (c) proof of a market price in excess of the par value of the stock or shares. The additional value allowed in any case is confined to the value definitely known or accurately ascertainable at the time of the payment. No claim will be allowed for a paid-in surplus in a case in which the additional value has been developed or ascertained subsequently to the date on which the property was paid in to the corporation, or in respect of property which the stockholders or their agents on or shortly before the date of such payment acquired at a bargain price, as for instance, at a receiver's sale. Generally, allowable claims under this article will arise out of transactions in which there has been no substantial change of beneficial interest in the property paid in to the corporation, and in all cases the proof of value must be clear and explicit.

**1193 Art. 837. Surplus and undivided profits: paid-in surplus.**—Where  
1038 it is shown by evidence satisfactory to the Commissioner that tangible property has been paid in by a stockholder to a corporation as a gift or at a value definitely known or accurately ascertainable as of the date of such payment clearly and substantially in excess of the cash or other consideration paid by the corporation therefor, then the amount of the excess shall be deemed to be paid-in surplus. Substantially the same kind of evidence will be required under this article as under article 836. (See further art. 813.)

**1194 Art. 838. Surplus and undivided profits: earned surplus.**—Only true  
1038 earned surplus and undivided profits can be included in the computation of invested capital, and if for any reason the books do not properly reflect the true surplus such adjustments must be made as are necessary in order to arrive at the correct amount. In the computation of earned surplus and undivided profits recognition should first be given to all expenses incurred and losses sustained from the original organization of the corporation down to the taxable year, including among such expenses and losses reasonable allowances for depreciation, obsolescence, or depletion of property (irrespective of the manner in which such property was originally acquired), and for the amortization of any discount on its bonds. There can, of course, be no earned surplus or undivided profits until any deficit or impairment of paid-in capital has been made good. Where explicit and convincing evidence is presented that the amounts written off or deducted in previous returns of net income are in the aggregate incorrect or unreasonable, adjustments

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must be made, and the taxpayer will be allowed a refund in respect of any taxes overpaid in prior years, or in the case of an underpayment of taxes will be additionally assessed.

**1195 Art. 839. Surplus and undivided profits: allowance for depletion and depreciation.**—Depletion, like depreciation, must be recognized in all cases in which it occurs. Depletion attaches to each unit of mineral or other property removed, and the denial of a deduction in computing net income under the act of August 5, 1909, or the limitation upon the amount of the deduction allowed under the act of October 3, 1913, does not relieve the corporation of its obligation to make proper provision for depletion of its property in computing its surplus and undivided profits. Adjustments in respect of depreciation or depletion in prior years will be made or permitted only upon the basis of explicit and convincing evidence (and calculations based upon a theoretical formula are not such evidence) that as at the beginning of the taxable year the amount of depreciation or depletion written off in prior years was insufficient or excessive, as the case may be, and in every such case due regard must be given to expenditures made by the taxpayer to maintain the effective usefulness of the property. Where deductions for depreciation or depletion have, either on the books of the corporation or in its returns of net income, been included in the past in expense or other accounts, rather than specifically as depreciation or depletion, or where capital expenditures have been charged to expense in lieu of depreciation or depletion, a statement indicating the extent to which this practice has been carried should accompany the return.

*[In connection with the foregoing read at ¶877.]*

**1196 Art. 840. Surplus and undivided profits: additions to surplus account.**—A corporation's books of account will be presumed to show the facts. If it claims that its capital or surplus account is understated the burden of proof will rest upon it. Additions to such accounts will be accepted to the following extent:

**1197** (1) Excessive depreciation heretofore charged off on property still owned and in use, if it is now shown by explicit and convincing proof to have been excessive and such excess is substantial in amount, whether or not disallowed by the Commissioner as a deduction from net income, may be restored to the surplus account. No such amount shall be restored, however, unless it is shown that adequate depreciation has been deducted upon all other property of the corporation still in use, nor in any case in which such amount has been allowed as a deduction for amortization under section 234 (a) (8) of the statute, or in which the cost of the property has been recovered through being included in the price of goods or services, as for example, in the case of patterns, dies, plates, special tools, etc., or under a munition contract with a foreign Government.

**1198** (2) Amounts which have been expended before January 1, 1917, for the acquisition of plant, equipment, tools, patterns, furniture, fixtures, or like tangible property, having a useful life extending substantially beyond the year in which the expenditure was made, and which have been charged as current expense, may (less proper deductions for depreciation or obsolescence) be added to the surplus account when such assets are still owned and in active use by the corporation during the taxable year. Special tools,



patterns, and similar assets shall not be assigned any value if their cost has been recovered through having been included in the price of goods. If their cost has not been so recovered and they are held for only occasional use, they shall not be assigned a value in excess of the fair value based upon the earnings actually arising from their current use, and in no case shall such value be more than the cost less depreciation. Assets of this kind not in current use shall not be valued at more than their nominal or scrap value.

**1199** (3) Amounts which have been expended in the past for intangible property of any kind can be restored to capital or surplus account only to the extent that the corporation specifically paid such amounts for the intangible property as such. For provisions relating to patents see article 843.

**1200** (4) Adjustments necessary to correct other errors found in the books of account may be made. But see the following article.

**1201** Art. 841. Surplus and undivided profits: limitation of additions to  
**1048** surplus account.—Additions to surplus which a corporation may desire to make under the preceding article fall broadly into two classes:

**1202** (1) To correct returns of net income for prior years in which actual errors have been made, as for example where excessive depreciation has been deducted, additions to plant and equipment or other capital charges have been charged off as an expense, inventories have been taken upon a wrong basis of valuation, etc.

**1203** (2) To reinstate in surplus deductions from income which are as a matter of good accounting to some extent optional, such as experimental expenses, patent litigation, development of good will through advertising or otherwise, etc.

**1204** Adjustments falling in class (1) will be permitted for all years whether before or after March 1, 1913, provided amended returns of net income are filed for each year in which an erroneous return has been made. Due consideration will be given to the assessment of penalties in any case in which a fraudulent return has been made. Adjustments falling in class (2) can not usually be permitted, as in such cases where the treatment of the item was optional and the decision made at the time conformed to the best accounting practice, it is considered that the corporation has exercised a binding option in deducting such expenses from income. An election of this sort which was made concurrently with the transaction can not now be revised, and amended returns in respect thereof can not be accepted.

**1205** The corporation shall submit with its return a statement of the additions proposed, specifying the kinds and amounts of property involved, the years in which the expenditures were made, and the method followed in distinguishing between capital outlays and current expenses, and showing that adequate provision has been made for depreciation, obsolescence, and depletion of such of the assets affected by the additions as are subject to recognized depreciation, obsolescence, or depletion. In any case in which there is an operating deficit amounts restored must first be set off against the

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deficit and only the excess can be actually included in the computation of invested capital.

**1206 Art. 842. Surplus and undivided profits: property paid in and subse-**  
**1038 quently written off.**—Where tangible or intangible property has been paid in to a corporation for stock or shares or where tangible property has been paid in as a paid-in surplus and has subsequently been in whole or in part written off the books, the amount so written off may upon evidence satisfactory to the Commissioner be restored to the capital or surplus account subject to the following limitations:

**1207** (1) The amount restored must be reduced by a proper deduction for any depreciation, obsolescence, or depletion; and

**1208** (2) The aggregate amount included in computing invested capital on account of such property shall not exceed the amount which might have been included if such property had not been written off.

**1209 Art. 843. Surplus and undivided profits: patents.**—From the stand-  
**1038** point of assets a patent, or more particularly a group of patents, is closely analogous to good will. Their value is contingent upon and measured by their earning power. While patents have a definite life, there is a common tendency to extend that life by improvements upon the original, and in a successful business the patent value merges more or less completely into a trade name or other form of good will. Therefore, while deductions in respect to the depreciation of patents based upon a normal life period of seventeen years are allowable in computing net income for the purpose of the income tax, such deductions are not obligatory, but are optional with each taxpayer. Where since January 1, 1909, a corporation has exercised that option to its own benefit in computing its taxable net income the amount so deducted can not now be restored in computing invested capital. Where, however, the cost of patents has been charged against surplus or otherwise disposed of in such a manner as not to benefit the corporation in computing its taxable net income since January 1, 1909, any amount so written off may be restored in computing invested capital, if it be shown to the satisfaction of the Commissioner that the amount so written off represented a mere book entry ascribable to a conservative policy of management or accounting and did not represent a realized shrinkage in the value of such assets. Any amount so restored may not be written off by way of deductions from taxable net income in any subsequent year or years. Where a corporation has charged to current expenses the cost of developing or protecting patents, no amount in respect thereof expended since January 1, 1909, can be restored in computing invested capital. In respect of expenditures made before January 1, 1909, a corporation now seeking to restore them must be prepared to show to the satisfaction of the commissioner that all such items are proper capital expenditures. It can not be said that the correct computation of surplus and undivided profits necessarily requires a deduction in respect of the expiration of patents. It follows, therefore, that where a corporation in the exercise of its option has not written down the cost of patents, it is not ordinarily necessary to reduce the surplus and undivided profits in computing invested capital, whether the patents have been acquired for stock or shares or for cash or other tangible property. Due consideration will be given to the facts in any case in which this rule seems obviously unreasonable. (See art. 167.)



**1210 Art. 844. Surplus and undivided profits: reserve for depreciation**  
 1038 **or depletion.**—If any reserves for depreciation or for depletion are included in the surplus account it should be analyzed so as to separate such reserves and leave only real surplus. Reserves for depreciation or depletion can not be included in the computation of invested capital, except to the following extent:

**1211** (1) Excessive depletion or depreciation included therein and which if charged off could be restored under article 840 may be included in the computation of invested capital; and

**1212** (2) Where depreciation or depletion is computed on the value as of March 1, 1913, or as of any subsequent date, the proportion of depreciation or depletion representing the realization of appreciation of value at March 1, 1913, or such subsequent date, may if undistributed and used or employed in the business be treated as surplus and included in the computation of invested capital.

**1213** For the purpose of computing invested capital, depreciation or depletion computed on the value as of March 1, 1913, or as of any subsequent date shall, if such value exceeded cost, be deemed a pro rata realization of cost and appreciation and be apportioned accordingly. Except as above provided, value appreciation which has not been actually realized and in respect of amounts accrued since March 1, 1913, reported as income for the purpose of the income tax, can not be included in the computation of invested capital, and if already reflected in the surplus account it must be deducted therefrom.

**1214 Art. 845. Surplus and undivided profits: reserve for income and excess**  
 1038 **profit taxes.**—For the purpose of computing invested capital, Federal income and war profits and excess profits taxes are deemed to have been paid out of the net income of the taxable year for which they are levied. It is immaterial, therefore, whether reserves for the payment of such taxes for the preceding year have been set up or not, or if set up whether such taxes when paid have actually been charged against such reserves. Amounts payable on account of such taxes for the preceding year may be included in the computation of invested capital only until such taxes become due and payable. A deduction from the invested capital as of the beginning of the taxable year must therefore be made for such taxes or any installment thereof, averaged for the proportionate part of the taxable year after the date when the tax or the installment is due and payable. Where as a result of an audit by the Commissioner, or the acceptance of an amended return, or for any other reason, the amount of any such tax for the preceding year is subsequently changed, a corresponding adjustment will be made in the invested capital for the taxable year upon the same basis as if the corrected amount of the tax for the preceding year had been used in the original computation of the invested capital for the taxable year. (See arts. 1541 and 1542.)

**1215 Art. 846. Surplus and undivided profits: insurance on officers.**—  
 1038 Where insurance is carried by the corporation on the life of an officer or employee, the policy may be included as an admissible asset and reflected in the surplus account at the cash surrender value as of the beginning of the taxable year. The whole amount of premiums paid on such insurance

can not be included in surplus, but the surplus will be considered as increased as of the beginning of each taxable year by the amount added to the cash surrender value of the policy. (See art. 294.)

**1216 Art. 847. Surplus and undivided profits: property taken for debt**  
1038 **or in exchange.**—Real or personal property taken by a corporation in payment or satisfaction of a debt, or property received in exchange for other property, will be an admissible asset at its fair market value upon receipt. The profit or loss, if any, resulting from the transaction will not be reflected in invested capital until the succeeding taxable year. But see as to the foreclosure of a mortgage article 153. (See also sec. 202 of the statute and arts. 1561-1570.)

**1217 Art. 848. Surplus and undivided profits: discount on sale of bonds.**—  
1038 Discount allowed on the sale of bonds is in effect an advance on account of interest, so that the effective rate of interest in such a case is equal to the sum of the nominal rate plus the rate necessary to amortize the discount over the life of the bonds. Where, under incorrect accounting practices, the discount on bonds has been charged to a property account or otherwise incorrectly carried as an asset, and is so reflected in the surplus account, it is necessary in computing invested capital to make an adjustment in respect of such discount. (See art. 563.)

**1218 Art. 849. Surplus and undivided profits: miscellaneous.**—Only the  
1038 amount of discount which has actually been reported by a bank in a prior year as taxable income and credited to surplus account may be included in surplus as of the beginning of the taxable year. For the treatment of surplus arising out of sales on the installment plan see articles 42-46, and from compensation for property lost, damaged, or condemned, see articles 49 and 261-263.

**1219 Art. 850. Surplus and undivided profits: current profits.**—Profits  
1038 earned during any year can not be included in the computation of invested capital for that year, even though during the year such profits are set up as surplus on the books or assumed to be distributed in the form of stock dividends. If a dividend is declared and paid during any year out of profits of that year and the stockholders pay back into the corporation all or a substantial part of the amount of such dividends, the amount so paid back can not be included in the computation of invested capital unless the corporation shows by evidence satisfactory to the Commissioner that the dividends were paid in good faith and without any understanding, express or implied, that they were to be paid back.

**1220 Art. 851. Intangible property paid in.**—The actual cash value of  
1039 intangible property paid in for stock or shares must be determined  
1040 in the light of the facts in each case. Among the factors to be considered are (a) the earnings attributable to such intangible assets while in the hands of the predecessor owner; (b) the earnings of the corporation attributable to the intangible assets after the date of their acquisition; (c) representative sales of the stock of the corporation at or about the date of the acquisition of the intangible assets; and (d) any cash offers for the purchase of the business, including the intangible property, at or about the time of its acquisition. A corporation claiming a value for intangible property paid in



for stock or shares should file with its return a full statement of the facts relating to such valuation. (See also art. 835.)

**1221 Art. 852. Percentage of inadmissible assets.**—For the purpose of  
1042 ascertaining the deductible percentage under section 326 (c) the amount of inadmissible assets held during the year may ordinarily be determined by dividing by two the sum of the amount of such assets held at the beginning of the year and the amount held at the end of the year. The total amount of admissible and inadmissible assets held during the year may ordinarily be determined by dividing by two the sum of the amount of such assets held at the beginning of the year and the amount at the end of the year. If at any time a substantial change has taken place either in the amount of inadmissible assets or in the total amount of admissible and inadmissible assets, the effect of such change shall be averaged exactly from the date on which it occurred. In any case where the Commissioner finds that either amount determined as above provided does not substantially reflect the average situation throughout the year, and that the amount of each kind of assets held on a given day of each month throughout the year or at more frequent regular intervals can be determined, the amount of inadmissible assets and the amount of both kinds of assets held during the year shall be determined by averaging the amounts held at such several times. In making the computations under this article the valuation at which each asset is carried shall be adjusted in accordance with the provisions of the statute and of the regulations relating to the valuation of assets for the purpose of computing invested capital, including in such adjustment the amount of reserves for depreciation, depletion, amortization and other reserves which represent the valuation of assets. It is immaterial whether any asset was acquired out of invested capital or out of profits earned during the year or borrowed capital.

**1222 Art. 853. Changes in invested capital during year.**—The invested  
1043 capital as of the beginning of any period of one year or less should be adjusted by an appropriate addition or deduction for each change in invested capital during the period. The amount so added or deducted in each case is the amount of the change averaged for the time remaining in the period during which it is in effect. The fraction used in finding such average is the number of days remaining in the period (including the day on which the change occurs) over the number of days in the period. Thus if a return is made for the calendar year ending December 31, 1921, and if \$100,000 of additional capital was paid in on February 17, 1921, this addition to invested capital is in effect for 318 days, and the amount to be added to the invested capital as of the beginning of the year would be  $318/365$  of \$100,000, or \$87,123.29. If \$50,000 of this amount was withdrawn on October 31, 1921, the amount to be deducted would be  $62/365$  of \$50,000, or \$8,493.15.

**1223 Art. 854. Computation of average invested capital.**—For the purpose  
1043 of computing invested capital for any period of one year or less each corporation shall add together its paid-in-capital and its paid-in or earned surplus and undivided profits (under whatever name it may be called) as shown by its books at the beginning of the period. The total so obtained shall be adjusted (a) for any property paid in, or for any asset reflected in surplus and undivided profits, which is not carried on the books at the valuation prescribed by the statute or by the regulations, and (b) for any changes in paid-in capital or in paid-in or earned surplus and undivided profits (not

including surplus and undivided profits earned during the period) occurring during the period, averaged for the time for which such changes are effective. (See art. 853.) The total so obtained and adjusted is the average invested capital for the period, unless the corporation at any time during the period held any inadmissible assets, in which case such total must be reduced by a percentage thereof equal to the percentage which the amount of inadmissible assets held during the period is of the total amount of admissible and inadmissible assets held during the period. (See art. 852.) The invested capital can not be determined by adding the amounts of the assets of a corporation.

**1224 Art. 855. Invested capital for full year or less.**—In the case of a corporation making a return for a full year of 12 months, its invested capital for the year is the average invested capital for the year. In the case of a corporation making a return for a fractional part of a year for the method of computing the changes in its invested capital made during the period, see article 856. Since in accordance with sections 239 and 226 the income is placed upon a yearly basis, the full average invested capital for the period should be used in computing the tax under this title. (See art. 718.)

**1225 Art. 856. Illustration of invested capital for fractional part of year.**—A corporation was organized July 1, 1921, and makes a return for the six months ending December 31, 1921. The invested capital consists of \$100,000 paid in on July 1 and \$100,000 paid in on October 1. The average invested capital for such period would be \$100,000 plus  $92/184$  (not  $92/365$ ) of \$100,000, or \$50,000, a total of \$150,000.

**1226 Art. 857. Method of determining available net income.**—Whether at the time of any payment made during the taxable year there is sufficient income of the taxable year available for such payment, or whether the surplus or undivided profits as of the beginning of the taxable year must be reduced by the amount of such payment, shall be determined according to the following principles:

**1227** (1) The aggregate amount of earnings of the taxable year available for all purposes up to any given date will be determined upon the basis of the same proportion of the net income for the taxable year (as finally determined for the purpose of income and excess profits taxes) as the part of the year already elapsed is of the entire year (determined in the manner provided in article 853), unless the corporation shows from its books or other records that a greater proportion of its earnings for the year was available on such date.

**1228** (2) The aggregate amount available will be deemed to be applied for the following purposes in the order in which they are stated: (a) Accrued Federal income and war profits and excess profits taxes for the taxable year (see art. 845), and (b) dividends paid after the expiration of the first sixty days of the taxable year (see sec. 201 of the statute and art. 1541) and other corporate purposes, including the purchase of outstanding stock of the corporation previously issued (see art. 862). In any case where the above computation would be indeterminate because of the effect of the provisions of this article upon the invested capital for the year, the amount of such invested capital for the purpose of this computation may be deemed to be the invested capital as of the beginning of the taxable year, plus any additional



capital paid in during such year and minus any specific withdrawal or liquidation of capital during such year.

**1229 Art. 858. Effect of ordinary dividend.**—A dividend other than a  
1038 stock dividend affects the computation of invested capital from the date when the dividend is payable and not from the date when it is declared, except that where no date is set for its payment the date when declared will be considered also the date when payable for the purpose of this article. For the purpose of computing invested capital a dividend paid after the expiration of the first sixty days of the taxable year will be deemed to be paid out of the net income of the taxable year to the extent of the net income available for such purpose on the date when it is payable. (See art. 857.) The surplus and undivided profits as of the beginning of the taxable year will be reduced as of the date when the dividend is payable by the entire amount of any dividend paid during the first sixty days of the taxable year and by the amount of any other dividend in excess of the current net income available for its payment. In the case of a dividend paid during the first sixty days of a taxable year which exceeds in amount the surplus and undivided profits as of the beginning of the taxable year the excess will be deemed to be paid out of earnings of the taxable year available at the date when the dividend is payable, and to the extent that such earnings are insufficient it will be deemed to be a liquidation of paid-in capital or surplus. From the date when any dividend is payable the amount which the several stockholders are entitled to receive will be treated as if actually paid to them, whether or not it is so paid in fact, and the surplus and undivided profits, either of the taxable year or of the preceding years, will in accordance with the foregoing provisions be deemed to be reduced as of that date by the full amount of the dividend. Amounts paid to stockholders in anticipation of dividends, or amounts withdrawn by stockholders in excess of dividends declared, will in computing invested capital have the same effect as if actually paid as dividends. (See also art. 813, and see generally sec. 201 [¶1005] and arts. 1541-1549.)

**1230 Art. 859. Effect of stock dividend.**—Neither the payment nor the  
1038 receipt of a true stock dividend has any effect upon the amount of invested capital. Such items as appraised value of good will, appreciation in value of real estate or other tangible property, etc., although carried to surplus and distributed as stock dividends, can not in this manner be capitalized and included in computing invested capital. If a corporation has paid a stock dividend in excess of its true surplus, it can not be deemed to have any greater invested capital than could have been computed had no such stock dividend been paid.

**1231 Art. 860. Impairment of capital.**—Capital or surplus actually paid  
1036 in is not required to be reduced because of an operating deficit, but where there has been directly or indirectly a liquidation or return of their investment to the stockholders, full effect must be given to any liquidation of the original capital.

**1232 Art. 861. Surrender of Stock.**—Where stock which has originally  
1036 been issued or exchanged by the corporation for property (tangible or intangible) is returned to the corporation as a gift or for a consideration substantially less than its par value, the stock so returned shall not

be treated as a part of the stock issued or exchanged for such property. The proceeds derived in cash or its equivalent from the resale of the stock so returned shall, however, be included in computing invested capital. (See art. 543.)

**1233 Art. 862. Purchase of stock.**—Where a corporation either directly  
 1036 or indirectly, as for example through a trustee, has prior to the taxable year bought its own stock, either for the purpose of retirement or of holding it in the treasury or for other purposes, the entire cost of such stock must be deducted from the aggregate invested capital as of the beginning of the taxable year, if such deduction has not already been made. Where such stock is purchased during the taxable year a deduction from the invested capital as of the beginning of the taxable year and effective from the date of such purchase is required only to the extent that such stock has not been purchased out of the undivided profits of the taxable year. (See art. 857). The full amount derived in cash or its equivalent from the resale of such stock may be included in the invested capital from the date of such resale, unless such stock had been purchased out of earnings of the taxable year. (See art. 543.)

**1234 Art. 863. Invested capital and other measures of capital.**—(a) The  
 1035 invested capital as here defined may differ from the capital as shown on the books of the corporation. In such event no changes should be made in the books themselves. The corporation should, however, in all cases keep a permanent record of the adjustments which are made in computing invested capital. (b) Section 1000 [¶3100] of the statute imposes a tax on the fair value of the capital stock of corporations. As in the case of the excess profits tax the invested capital is based upon the actual investment of the stockholders in the corporation, irrespective of the present value of its assets, and in the case of the capital stock tax the fair value looks to the present value of the corporation's assets, irrespective of the amount of the investment of the stockholders therein, the amount determined as the fair value of the capital stock for the purpose of the capital stock tax can have no bearing upon the determination of invested capital. (See also art. 1561.)

**1235 Art. 864. Affiliated corporations: invested capital.**—The invested  
 1078 capital of affiliated corporations, as defined in section 240 (c) of the statute and article 633, for the taxable year is the invested capital of the entire group treated as one unit operated under a common control. As a first step in the computation a consolidated balance sheet should be prepared in accordance with standard accounting practices, which will reflect the actual assets and liabilities of the affiliated group. In preparing such a balance sheet all intercompany items, such as intercompany notes and accounts receivable and payable, should be eliminated from the assets and the liabilities, respectively, and proper adjustments should be made in respect of intercompany profits or losses reflected in inventories which at the beginning or end of the taxable year contain merchandise exchanged between the corporations included in the affiliated group at prices above or below cost to the producing or original owner corporation. Such consolidated balance sheet will then show (a) the capital stock of the parent or principal company in the hands of the public; (b) the consolidated surplus belonging to the stockholders of the parent or principal company; and (c) the capital stock, if any, of subsidiary companies of which substantially all the capital stock is not owned or controlled by the



**WAR-PROFITS AND EXCESS-PROFITS TAX REGULATIONS, ETC.—1922-1923.**

parent or principal company, together with the surplus, if any, belonging to such minority interest. In computing consolidated invested capital the starting point is furnished by the total of the amounts shown under (a), (b), and (c) above. This total must be increased or diminished by any adjustments required to be made under the provisions of sections 325, 326 and 331 of the statute and articles 811-818, 831-869, and 941 of the regulations, except as otherwise provided in articles 865-868.

**1236 Art. 865. Affiliated corporations: intangible property paid in.—(1)**

1078 In respect of corporations whose affiliation is in the nature of parent and subsidiary companies: (a) In the case of intangible property bona fide paid in for stock or shares prior to March 3, 1917, there may be included in invested capital an amount not exceeding the actual cash value of such property at the time paid in, or the par value of the stock or shares issued therefor, or in the aggregate 25 per cent of the par value of the total stock or shares of the consolidation outstanding on March 3, 1917 (determined as indicated in items (a) and (c) in art. 864), or in the aggregate 25 per cent of the par value of the total stock or shares shown on the consolidated balance sheet, being the amount of the capital stock included in items (a) and (c) in article 864 at the beginning of the taxable year, whichever is lowest; and (b) in the case of intangible property bona fide paid in for stock or shares on or after March 3, 1917, there may be included in invested capital an amount not exceeding the actual cash value of such property at the time paid in, or the par value of the stock or shares issued therefor, or in the aggregate 25 per cent of the par value of the total stock or shares shown by the consolidated balance sheet, being the amount of the capital stock included in items (a) and (c) in article 864 outstanding at the beginning of the taxable year, whichever is lowest. (c) When intangible property has been acquired in part before and in part after March 3, 1917, the amounts shall be ascertained, respectively, under (a) and (b) above and in the aggregate shall in no case exceed 25 per cent of the par value of the total stock or shares outstanding at the beginning of the taxable year shown in the consolidated balance sheet, being the amount of the capital stock included in items (a) and (c) in article 864.

**1237** (2) In respect of corporations affiliated by reason of stock ownership or control by the same interests, the limitations set forth in paragraphs (4) and (5) of subdivision (a) of section 326 of the statute shall be applied to each corporation separately and the aggregate of the intangible property, so valued, shall be included in invested capital in the consolidated return. In respect of each of the affiliated corporations the aggregate of the amounts ascertained under the provisions of paragraphs (4) and (5) shall in no case exceed 25 per cent of the outstanding capital stock of such corporation at the beginning of the taxable year.

**1238 Art. 866. Affiliated corporations: inadmissible assets.—Where adjust-**

1078 ment is required in respect of inadmissible assets in accordance with the provisions of subdivision (c) of section 326 of the statute, such adjustment shall be made on the basis of the consolidated balance sheet with due regard to the adjustments and eliminations set forth in articles 864 and 865 and to the provisions of articles 815-818.

**1239 Art. 867. Affiliated corporations: stock of subsidiary acquired for**

1078 cash.—When all or substantially all of the stock of a subsidiary corporation was acquired for cash, the cash so paid shall be the basis to be used in determining the value of the property acquired.

**WAR-PROFITS AND EXCESS-PROFITS TAX REGULATIONS, ETC.—1922-1923.**

**1240 Art. 868. Affiliated corporations: stock of subsidiary acquired for**  
 1078 **stock.**—Where stock of a subsidiary company was acquired with the stock of the parent company, the amount to be included in the consolidated invested capital in respect of the company acquired shall be computed in the same manner as if the net tangible assets and the intangible assets had been acquired instead of the stock. If in accordance with such acquisition a paid-in surplus is claimed, such claim shall be subject to the provisions of article 837.

**1241 Art. 869.\* Insurance companies.**—The reserve funds of insurance  
 1031 companies (other than life) the net additions to which are deductible  
 1041 from gross income under the provisions of section 234 of the statute, may be included in computing invested capital. See secs. 325 and 326 and arts. 569 and 814.

*\*Was Art. 870 of Reg. 45. Therefore, for Supplementary Bulletin Rulings bearing on this Article, refer to Art. 870 in the Supplementary Bulletin Rulings.*

**1242 Art. 870.\* Foreign corporations.**—Inasmuch as the excess profits tax  
 1044 in the case of a foreign corporation or of a corporation entitled to  
 1046 the benefits of section 262 [¶1083] is not based on the invested capital of the corporation, but is computed in accordance with section 328 of the statute, the provisions of section 326 and of articles 831-868 have no application to foreign corporations. For the same reason, when rendering a return of income on Form 1120 for a foreign corporation, no entry of invested capital should be made thereon. (See art. 962.)

*\*Was Art. 871 of Reg. 45. Therefore, for Supplementary Bulletin Rulings bearing on this Article, refer to Art. 871 in the Supplementary Bulletin Rulings.*

**SPECIAL CASES**

**1243 Art. 901. Treatment of special cases.**—In the cases specified in section  
 1044 327 of the statute the tax will be specially determined under the provisions of section 328, but the tax will not ordinarily be computed under section 328 merely because the corporation's form or manner of organization, or the limitations imposed by section 326, result in a greater tax than would otherwise be payable. A corporation which comes within the provisions of subdivision (d) of section 327 may make application for assessment under the provisions of section 328, which application shall be attached to its return in the form of a statement setting forth in full: (a) The reasons why the tax should be so determined; (b) the facts upon which such reasons are based; (c) an exact description of each trade or business or important branch of a trade or business carried on by it; (d) a statement of the invested capital and net income for each year since the beginning of the prewar period; and (e) a statement showing the amount of gains, profits, commissions, or other income derived on a cost-plus basis from Government contracts made after April 5, 1917, and before November 12, 1918, and showing the per cent which such income is of the total income of the corporation. (See secs. 2 [¶1003] and 326 and arts. 831-870 and 1510.)

**COMPUTATION OF TAX IN SPECIAL CASES**

**1244 Art. 911. Computation of tax in special cases.**—In the cases specified  
 1049 in section 327 of the statute the tax is to be computed by comparison with representative corporations whose invested capital can be satis-



factorily determined under section 326 and which are engaged in a like or similar trade or business and similarly circumstanced. The provisions of section 328 do not permit the determination of a general average for any trade or business. In each case which comes under the provisions of section 327 the Commissioner will determine, as nearly as may be, the group or class of corporations with which the corporation should be compared and the amount which bears the same ratio to the net income of the corporation (in excess of the specific exemption of \$3,000) for the taxable year as the average tax of such representative corporations bears to their average net income (in excess of the specific exemption of \$3,000) for such year. The comparison will take account of similarity with respect to character of business, size and condition of plant, gross income, net income, profit per unit of business transacted and capital employed, the amount and rate of war profits or excess profits, and all other relevant facts and circumstances.

**1245 Art. 912. Determination of first installment of tax in special cases.**—In the case of any corporation, other than a foreign corporation or a corporation entitled to the benefits of section 262 [¶1083], where no data are available for the determination of invested capital for the taxable year, the installments of the tax shall in the first instance be determined upon the basis of an excess profits tax equal to 20 per cent of the net income in excess of \$3,000, but not in excess of \$20,000, plus 40 per cent of the net income in excess of \$20,000. In any other case under section 328 of the statute, other than the case of a foreign corporation or a corporation entitled to the benefits of section 262 [¶1083], but including a case where the invested capital for the taxable year can not be accurately determined, but where a minimum amount of invested capital can be determined with reasonable accuracy, the installments shall in the first instance be determined upon the basis of an excess profits tax computed by using the minimum invested capital, the tax in any such case not to exceed 20 per cent of the net income in excess of \$3,000, but not in excess of \$20,000, plus 40 per cent of the net income in excess of \$20,000.

**1246 Art. 913. Determination of first installment of tax in the case of foreign corporation or a corporation entitled to the benefits of section 262.**—In the case of a foreign corporation or a corporation entitled to the benefits of section 262 [¶1083] the installments of the tax shall in the first instance be determined upon the basis of a war profits and excess profits tax computed by using its invested capital for the taxable year 1917, such tax for the calendar year 1921 not to exceed 20 per cent of the net income not in excess of \$20,000, plus 40 per cent of the net income in excess of \$20,000. For the purpose of this article the invested capital for 1917 shall be adjusted for any subsequent changes in its amount due to cash or property paid in or withdrawn or to surplus or undivided profits of prior years retained in the business and properly attributable to its business within the United States. If the tax for 1917 was determined under section 210 of the revenue act of 1917, the constructive capital which would result in a tax equivalent to the tax determined under that section shall be used. In the case of a foreign corporation or a corporation entitled to the benefits of section 262 [¶1083] which was organized subsequent to the taxable year 1917, or which had no income from sources within the United States during 1917, the installments of the tax shall in the first instance be determined upon the basis of an excess profits tax equal to 20 per cent of the net income not in excess of \$20,000, plus 40 per cent of the net income in excess of \$20,000.

**1247 Art. 914. Payment of tax in special cases.**—In any case falling under  
 1049 the last two articles the installments shall be paid upon the basis therein provided until the Commissioner notifies the corporation of the amount of tax computed under section 328. The installments shall then be recomputed upon the basis of an excess profits tax of such amount, and if the amount already paid is less than the amount which would have already become due if the installments had originally been computed upon that basis, the additional amount shall be due and payable ten days after notice and demand from the collector.

### REORGANIZATIONS

**1248 Art. 941. Valuation of asset upon change of ownership.**—Where a  
 1053 business is reorganized, consolidated, or transferred, or property is transferred, after March 3, 1917, and an interest or control of 50 per cent or greater in such business or property remains in the same persons or any of them, then for the purpose of determining invested capital each asset so transferred is valued (a) at an amount representing its actual cash value, subject to the limitations imposed by section 326, but not exceeding its allowable value, for invested capital purposes, in the possession of the previous owner, if a corporation, or, if not a corporation (b) at its cost to such previous owner, with proper adjustments for losses and improvements.

### FISCAL YEARS ENDING IN 1921 OR 1922

**1249 Art. 951. Fiscal year with different rates.**—Section 335 of the statute  
 1054 applies to the war profits and excess profits tax. For provisions with respect to the income tax see section 205 of the statute and articles 1621-1624. Subdivision (a), which deals with fiscal years beginning in 1920 and ending in 1921, and subdivision (b) which deals with fiscal years beginning in 1921 and ending in 1922, apply to corporations other than personal service corporations.

**1250 Art. 952. Fiscal year of corporation ending in 1921.**—The method  
 1054 provided for computing the tax for a fiscal year beginning in 1920 and ending in 1921 is as follows: (a) The tax attributable to the calendar year 1920 is found by computing the income of the taxpayer and the tax thereon in accordance with the revenue act of 1918 as if the fiscal year was the calendar year 1920, and determining the proportion of such tax which the number of months falling within the calendar year 1920 is of the number of months in the entire period; (b) the tax attributable to the calendar year 1921 is found by computing the income of the taxpayer and the tax thereon in accordance with the present statute as if the fiscal year was the calendar year 1921, and determining the proportion of such tax which the number of months falling within the calendar year 1921 is of the number of months in the entire period; and (c) the tax for the fiscal year is found by adding the tax attributable to the calendar year 1920 and the tax attributable to the calendar year 1921.

**1251 Art. 953. Credits in the case of fiscal year ending in 1921.**—  
 1054 Amounts previously paid by the taxpayer on account of the excess profits tax for its fiscal year ending in 1921 shall be credited towards the payment of the excess profits tax imposed for such fiscal year by the



present statute. Any excess shall be credited or refunded in accordance with the provisions of section 252 of the statute. For credits for foreign taxes, see section 238 of the statute and article 611.

**1252 Art. 954. Fiscal year of corporation ending in 1922.**—The method provided for computing the tax for a fiscal year beginning in 1921 and ending in 1922 is as follows: The tax attributable to the calendar year 1921 is found by computing the income of the taxpayer and the tax thereon in accordance with the statute as if the fiscal year was the calendar year 1921, and determining the proportion of such tax which the number of months falling within the calendar year 1921 is of the number of months in the entire period. For credits for foreign taxes, see section 238 of the statute and article 611.

**1253 Art. 955. Illustrations of computation of tax for fiscal year.**—  
**1055** (a) A corporation makes its return on the basis of a fiscal year ending March 31, 1921. Its invested capital and net income are \$100,000 and \$74,000, respectively, as computed under the revenue act of 1918, and \$100,000 and \$68,000, respectively, as computed under the present statute. Such a difference in amounts of net income may readily occur owing to differences in the provisions of the two statutes.

**1254** (1) The excess profits tax, computed under the revenue act of 1918 upon the basis of an invested capital of \$100,000 and a net income of \$74,000, is \$23,400.

**1255** (2) The excess profits tax computed under the revenue act of 1921, upon a basis of an invested capital of \$100,000 and a net income of \$68,000, is \$21,000.

**1256** (3) The total excess profits tax for the fiscal year ending March 31, 1921, will be the sum of (a) the proportion of the tax computed under the revenue act of 1918 which the portion of the fiscal year falling within the calendar year 1920 is of the entire period (i.e., nine-twelfths of the excess-profits tax, \$23,400, computed under revenue act of 1918) or \$17,550, and (b) the proportion of the tax computed under the revenue act of 1921 which the portion of the fiscal year falling within the calendar year 1921 is of the entire period (i.e., three-twelfths of the excess profits tax, \$21,000, computed under the revenue act of 1921) or \$5,250. The total excess profits tax is \$17,550 plus \$5,250, or \$22,800.

**1257** (b) The excess profits tax for a fiscal year ending in 1922 will be an amount equivalent to the same proportion of a tax computed under this statute which the portion of such period falling within the calendar year 1921 is of the entire period. In the case of a corporation making its return on the basis of a fiscal year ending March 31, 1922, having an invested capital and net income of \$100,000 and \$68,000 respectively, the excess profits tax computed under the revenue act of 1921 will be \$21,000. The tax applicable to the fiscal year ending March 31, 1922, is \$15,750 (i.e., nine-twelfths of the excess profits tax, \$21,000).

## RETURNS

**1258 Art. 961. Returns.**—Every corporation, except life insurance com-  
 1056 panies, domestic or foreign, not exempt under section 304 of the  
 statute and article 751, shall make a return for the purpose of excess  
 profits tax on form 1120. The return shall be made and the tax shall be paid  
 as provided in the case of a return for and payment of the income tax by cor-  
 porations. See generally Parts II A and III of the regulations and particu-  
 larly sections 239, 240, 241, 250, and 253 of the statute and the articles  
 thereunder.

**1259 Art. 962. Returns in special cases.**—Where a corporation coming  
 1014 under the provisions of section 301 (b) of the statute computes  
 1049 its war profits credit upon the basis of the sum of (a) the specific  
 exemption and (b) an amount equal to 10 per cent of the invested  
 capital for the taxable year, the items on form 1120 which relate solely to the  
 net income or to the invested capital for the prewar period need not be filled  
 in. Where such a corporation enters on its return a war profits and excess  
 profits tax equal to the amount of the maximum tax determined under section  
 302 of the statute, the items on form 1120 which relate solely to the net  
 income for the prewar period and the items which relate to the invested capital  
 for the prewar period and for the taxable year need not be filled in. Likewise  
 in the case of a foreign corporation, or a corporation entitled to the benefits  
 of section 262, the same items may be disregarded, except that balance sheets  
 as of the beginning and the end of the taxable year for the entire business  
 of the corporation both within and without the United States shall be sub-  
 mitted. See article 870. The Commissioner may at any time specifically  
 call for all or any part of the information which under this article is not  
 required to be entered on the return. In any case, however, where a claim  
 is made under sections 327 and 328 of the statute, other than in the case of a  
 foreign corporation, or a corporation entitled to the benefits of section 262,  
 the corporation should fill out all items of the return so far as possible and  
 submit a statement explaining why it is impracticable to fill out the entire  
 return.

## SALE OF MINERAL DEPOSITS

**1260 Art. 971. Tax on sale of mineral deposits.**—In the case of a sale of  
 1057 mines, oil or gas wells, or any interest therein, as described in article  
 13, the portion of the war profits and excess profits tax attributable  
 to such a sale shall not exceed 20 per cent of the selling price. To determine  
 the application of this provision to a particular case the corporation should  
 compute the war profits and excess profits tax in the ordinary way upon its  
 net income, including its net income from any such sale. The proportion  
 of the total tax indicated by the ratio which the taxpayer's net income from  
 the sale of the property, computed as prescribed in article 714, bears to its  
 total net income is the portion of the tax attributable to such sale, and if it  
 exceeds 20 per cent of the selling price of the property such portion of the tax  
 shall be reduced to that amount. (See arts. 219-221.)

**1261 Art. 972. Illustration of computation of tax where sale of mineral**  
 1057 **deposits.**—In the case of the corporation used as an illustration in  
 article 715, let it be assumed that its gross income for 1921 included  
 \$15,000 derived from a bona fide sale of an oil well, the principal value of



which had been demonstrated by exploration and discovery work done by the corporation, and that the Commissioner finds under article 714 that only \$800 of the deductions allowed are properly applicable to the gross income derived from the sale. The portion of the net income attributable to the sale would be \$14,200, which is 35.5 per cent of the entire net income of \$40,000, and the portion of the tax for that year attributable to the sale will be 35.5 per cent of the entire tax of \$9,240, or \$3,280.20. But this portion of the tax can not exceed 20 per cent of the selling price (\$15,000) and is accordingly reduced to \$3,000. The total tax will be \$5,959.80 (the portion of the tax not affected) plus \$3,000, or \$8,959.80 (instead of \$9,240).

### EFFECTIVE DATE OF TITLE

- 1262** Art. 980. Effective dates.—This title takes effect as of January 1,  
1058 1921. It imposes no tax for any period prior to that date or subsequent to December 31, 1921.

### CONSOLIDATED RETURNS FOR YEAR 1917

- 1263** Art. 1735. Consolidated returns for year 1917.—Section 1331 applies  
1079 only to the tax [war-profits and excess profits taxes] levied by the Revenue Act of 1917. See Regulations 41.

[See rulings beginning at ¶1266.]

### RULES AND REGULATIONS

- 1264** Art. 1800. Promulgation of regulations.—In pursuance of the statute  
the foregoing regulations are hereby made and promulgated and all  
rulings inconsistent herewith are hereby revoked.

DAVID H. BLAIR,  
*Commissioner of Internal Revenue.*

Approved February 15, 1922.

A. W. MELLON,  
*Secretary of the Treasury.*

## OFFICIAL RULINGS, REGULATIONS, OPINIONS, AND DECISIONS

## UNDER THE LAW IMPOSING A

## WAR-PROFITS AND EXCESS-PROFITS TAX FOR 1921

## AND UNDER

## PRIOR WAR-PROFITS AND EXCESS-PROFITS TAX LAWS

## MADE AVAILABLE DURING 1922 AND 1923,

## OTHER THAN REGULATIONS 62, PART II-B

## WHICH APPEARS IN FULL BEGINNING ON PAGE 425.

**1265** Article 836, Regulations 45, (1920 edition) and Article 836, Reg-  
**757** ulations 62, amended.—Article 836, Regulations 45, (1920 edition)  
**1192** and Article 836, Regulations 62, are hereby amended to read as follows:

Article 836. Tangible property paid in; value in excess of par value of stock.—The paid-in surplus allowed in any case is confined to the value definitely known or accurately ascertainable at the time the property is paid in. Evidence offered to support a claim for a paid-in surplus must be as of the date of the payment. It may consist among other things of (a) an appraisal of the property by disinterested authorities; (b) a certificate of the assessed value in the case of real estate, or (c) evidence of a market price in excess of the par value of the stock or shares. Opinion evidence, expert or otherwise, of the value of property as of a prior date will not be accepted. Retrospective appraisals submitted in support of a claim for a paid-in surplus will not be accepted in any case where other reasonably satisfactory evidence is available and in any case will be accepted only after rigid scrutiny and will be followed only to the extent to which their reasonableness is fully established. The property which was paid in is the basis of the appraisal, and the appraisal must reconcile the accounts so as to reflect accurately the actual value on the date as of which the appraisal is made and the depreciation sustained. Proper consideration must in all cases be given to depreciation and the expired and remaining serviceable life of the property must be shown. To be acceptable retrospective appraisal must show: (1) the history of the business and manner in which the information or data was acquired; (2) the manner in which the appraisals were constructed; (3) the inventory on the date of the appraisal in detail; (4) the date of acquisition of all items remaining in the inventory as of the date of appraisal; (5) the elimination from the inventory of all items acquired subsequent to the date as of which the appraisal is made and how this was effected (all items, the date of acquisition of which can not be definitely determined, should be listed separately and all the facts bearing upon the date of acquisition given); (6) the replacement cost at the date as of which the appraisal is made of each item accepted as on hand on that date determined upon competent data, with a statement of the method employed in arriving at such cost (estimate and general statements will not be accepted); (7) the rate and total amount of depreciation as shown by the books; (8) the rate and total amount of depreciation taken upon each item included in the appraisal for the purposes of the appraisal (if other than normal rates of depreciation are used the reason therefor and the method of computing depreciation must be fully explained); (9) the actual cost when ascertainable of each item included in the appraisal; (10) the book value on the date as of



which the appraisal is made of all the items included in the appraisal, and (11) a detailed statement of all plant facilities and additions, represented by capital expenditures previously written off, which were still in use on the date as of which the appraisal was made and all the depreciation actually sustained or accrued on such items. No claim will be allowed for paid-in surplus in any case in which the addition of value has been developed or ascertained subsequent to the date on which the property was paid in to the corporation, or in respect of property which the stockholders or their agents on or shortly before the date of such payment acquired at a bargain price, as for instance, at a receiver's sale. Generally, allowable claims under this article will arise out of transactions in which there has been no substantial change of beneficial interest in the property paid in to the corporation and in all cases the proof of value must be clear and explicit. (T. D. 3367, July 10, 1922.)

[Comment: All in amended Article 836, as printed above, relating to retrospective appraisals is new. Otherwise no change in effect except that the word "evidence" in (c) in the third sentence was formerly "proof."—The Corporation Trust Company.]

**1266** Allocations of tax: Partnerships and corporations in consolidated cases. (1917-1921 Acts.)—An opinion is requested in the consolidated case of the M Company, wherein corporations and partnerships are consolidated, as to the proper basis of allocating the tax between the units of the consolidation.

**1267** No opinion is requested as to whether or not the corporations are properly consolidated and no opinion is expressed upon this question.

**1268** In the request attention is called to article 78, Regulations 41, on the subject of allocating the excess profits taxes in consolidated cases involving corporations, and objections are pointed out to allowing taxpayers the option to allocate the excess profits taxes to partnerships in cases where both corporations and partnerships are consolidated. Article 78, Regulations 41, reads as follows:

*When affiliated corporations may be required to make consolidated returns.*—Whenever necessary to more equitably determine the invested capital or taxable income, the Commissioner of Internal Revenue may require corporations classed as affiliated under article 77 to furnish a consolidated return of net income and invested capital. Where such consolidated return is required it may be made by any one or more of such corporations or by all of them acting jointly; but if such affiliated corporations, when requested to file such consolidated return, neglect or refuse to do so, the Commissioner of Internal Revenue may cause an examination of the books of all such corporations to be made and a consolidated statement to be made for such examination. In cases where consolidated returns are accepted, the total tax will be computed in the first instance as a unit upon the basis of the consolidated return and will be assessed upon the respective affiliated corporations in such proportions as may be agreed among them. If no such agreement is made the tax will be assessed upon each such corporation in accordance with the net income and invested capital properly assignable to it.

**1269** It is clear that the above-quoted article applies only to cases where corporations are consolidated, and not to cases where corporations and partnerships are consolidated.

**1270** Consolidated returns are required because otherwise opportunity would be afforded affiliated corporations and partnerships to evade taxes by the shifting of income through price fixing, charges for service, and other means by which income can be arbitrarily assigned to one or another unit of the group. The reason for permitting the taxpayer in consolidated

cases an option as to the allocation of the excess profits tax as between corporations is that all corporations pay the same rate of income tax and the allocation of the excess profits tax as between corporations would make no difference in the total income and excess profits taxes received by the Government. This reason, however, does not apply where partnerships are included in the consolidation with corporations, because the individual members of partnerships do not pay their income tax at the same rate as corporations. To allow the taxpayer to allocate the excess profits tax in cases where corporations and partnerships are consolidated might therefore result in defeating one of the purposes for requiring consolidated returns in affiliated cases. While individual members of the partnerships pay income taxes at different rates than corporations, all individual members of the partnerships pay income taxes at the same rate. It appears, therefore, that there would be no objection to allowing the taxpayers the option to allocate to the partnership units the excess profits tax properly assignable to the partnership group.

**1271** In the request attention is called to the difficulties of applying the last sentence of article 78 to consolidated cases where several units

of the consolidation have losses and where there is doubt as to the invested capital properly assignable to each unit. These difficulties as to the practical application of the article are recognized in such cases where it is sought to allocate the tax according to the invested capital and net income of each unit of the consolidation, but it is believed that it will be found that these difficulties disappear within the groups if the corporations are treated as one group and the partnerships as another. While the units of the two groups (units of the partnership group here mean the individual partners) will pay their *income taxes* at different rates, the units of the same group will pay their *income taxes* at the same rates, and if the excess profits tax is allocated to each group, according to the invested capital and net income assignable to the group, all difficulties disappear and the tax is equitably allocated.

**1272** It is held, therefore, that where corporations and partnerships are consolidated the excess profits tax should be allocated to the partnerships as a group according to the invested capital and net income assignable to the partnership group. After the proper amount of the excess profits tax has been allocated to the partnership group, article 78 may then be applied within the partnership group as it is now applied within the corporation group. (Law Opinion 1085, signed by Solicitor of Internal Revenue Carl A. Mapes, and issued January 16, 1922.)

**1273 Consolidated Returns for Year 1917.**—The Committee has carefully  
1079 considered the appeal of the M Company from the action of the  
1263 Income Tax Unit in requiring consolidated returns from the appellant company and the O Company for the years 1917, 1918, and 1919.

The relevant facts indicate that the M Company was organized for the purpose of engaging in the real estate brokerage business; that its income is derived solely from commissions earned from the sales and rental of real estate, from placing insurance, and from activities of a similar nature; that the O Company was organized by A for the purpose of holding such parcels of real estate as he might from time to time acquire. During the year 1917 the O Company made no purchases or sales of any property, and its income consisted of rents received from houses owned. Since the organization of the two corporations the only intercompany transactions which have occurred are two loans of  $x$  dollars each; in each instance, however, interest was charged at a commercial and legal rate of 6 per cent. During 1917 A owned 100 per cent of the capital



stock of the O Company and 86 per cent of the stock of the M Company; A's wife owned 4 per cent of the stock of the M Company; and the remaining 10 per cent of the stock of that corporation was owned by the secretary of the corporation, who also acted as secretary of the O Company.

In considering the point at issue so far as concerns the taxable year 1917, the Committee has referred to articles 77 and 78 of Regulations 41 issued under the Revenue Act of 1917 and the provisions of T. D. 2662. Consideration has also been given to section 1331 of the Revenue Act of 1921, which treats of the conditions and requirements for the filing of consolidated returns for the taxable year 1917.

Section 1331, Revenue Act of 1921, provides [¶1079 herein].

A careful analysis of the provisions of the above-quoted section when considered in connection with the facts and conditions obtaining in this case leads the Committee to the conclusion that the M Company and the O Company were not affiliated or interrelated to the extent of requiring a consolidated return for the taxable year 1917.

However, consideration of this matter for the years 1918 and 1919 presents a different situation and requires a determination under the provisions of section 240, Revenue Act of 1918, as amplified by article 631 of Regulations 45. Section 240, Revenue Act of 1918, provides as follows:

- (a) That corporations which are affiliated within the meaning of this section shall \* \* \* make a consolidated return of net income and invested capital \* \* \*  
 (b) For the purpose of this section two or more domestic corporations shall be deemed to be affiliated (1) if one corporation owns directly or controls through closely affiliated interests or by a nominee or nominees substantially all the stock of the other or others, or (2) if substantially all of the stock of two or more corporations is owned or controlled by the same interests.

This section provides that corporations are affiliated when substantially all of the stock is merely controlled by the same interest. It also omits the three limiting provisions of section 1331, Revenue Act of 1921, which apply to returns for the taxable year 1917. While it is true that the requirement of consolidated returns is based upon the principle of levying the tax according to the true net income and invested capital of a single business enterprise, even though the business is operated through more than one corporation, section 240 specifically defines affiliated corporations and provides that such corporations shall file consolidated returns. It necessarily follows that whether the corporations in the instant case should file consolidated returns for 1918 and 1919 depends wholly on the question as to whether or not substantially all of their stock was *owned or controlled* by the same interests during these years. The foregoing statement of facts indicates that the sole stockholder of the O Company owned 86 per cent of the stock of the M Company and that 10 per cent of the stock of the latter company was owned by the secretary of the O Company.

Upon such facts the Committee is brought to the conclusion that such stock ownership constitutes *control* within the meaning of section 240 of the Revenue Act of 1918 and, accordingly, that these corporations were affiliated to the extent of requiring consolidated returns for the years 1918 and 1919.

The Committee therefore recommends in the appeal of the M Company that consolidated returns should be required for the years 1918 and 1919 in accordance with the requirements of section 240, Revenue Act of 1918, and that such returns should not be required for 1917 under the provisions of articles 77 and 78 of Regulations 41, issued under the Revenue Act of 1917, and section 1331, Revenue Act of 1921. (I-16-234:A. R. R. 855.—June 1922 Cum. Bull. p. 413.)

## WAR-PROFITS AND EXCESS-PROFITS TAX REGULATIONS, ETC.—1922-1923.

**1274** Consolidated returns for year 1917.—The Committee has had under  
 1079 consideration the appeal of the M Company, the O Company, and  
 1263 P Company from the ruling of the Income Tax Unit that these companies were affiliated and must file consolidated returns of net income for the years 1917, 1918, and 1919.

**1275** The O Company and the P Company were old established businesses even prior to 1913, and on January 1, 1917, the capital stock outstanding was held as follows:

	O Company	P Company
	Per cent.	Per cent.
A.....	35.0	50
B.....	15.0	None
C.....	.2	25
D.....	49.8	25

B is the wife of A; D is the wife of C, and the sister of A.

In a sworn statement of facts filed with the case it is stated:

In the years prior to 1917, C had made numerous attempts to acquire a more substantial holding in the O Company, but none of the stockholders in the O Company would part with any of their stock. Early in 1917, C succeeded in getting the stockholders of the O Company to agree to sell certain of the assets of the O Company to a new corporation, the M Company, with a capital of  $x$  dollars, in which company he was to have 10 per cent of the stock with the understanding that if the new corporation subsequently increased its capital stock, as was then contemplated, he was to have the privilege of increasing his holdings. At the date of the incorporation of said company, A acquired  $49\frac{9}{10}$  per cent of the stock; B acquired  $1/10$  per cent, and D acquired 40 per cent of the stock. On January 2, 1918, the capital stock was increased to  $1.3x$  dollars, after which increase, C owned 15 per cent of the stock; D owned 35 per cent of the stock; the other holdings remaining approximately the same. On August 1, 1918, the capital stock was further increased, after which increase C owned 22 per cent of the stock, D owned 28 per cent of the stock, the other holdings remaining approximately the same. It will be noted that the stockholdings in the M Company were in different proportions than the stockholdings in either of the other two corporations.

**1276** The record shows that the O Company and the P Company ceased active operations on August —, 1917, when the M Company was organized and commenced operations. The appellants state that it was the intention to liquidate the two companies first named as soon as possible, but this was not finally accomplished until April, 1919, the reason for the delay being that the stockholders could not agree on the value of the good will of the old companies, on account of the fact that the four individual stockholders owned different amounts of stock in each of these companies and their individual interests were affected differently in each company; that it was not until the full effect of the Food Administration rules upon the business could be determined that it was possible for the conflicting interests to reach an agreement as to the value of this good will, and that, pending final settlement, a temporary arrangement was entered into through which the new company paid to the old companies certain royalties per unit of output. It is further stated that in the early part of 1919, after the suspension of control by the Food Administration, it was apparent that the good will of the old companies had practically been destroyed and that the future of the new company must be based primarily on its own efforts and ability to stay in the business. Proper action was then taken to liquidate the affairs of the old companies, which were finally dissolved in April, 1919.



**1277** From the above it is apparent that at all times A and his wife and C and his wife together owned exactly 50 per cent of the stock in each of the three corporations and the Unit has held that, as the interests of husband and wife are identical, the capital stock of the three companies was held by the same interests in the same proportion and that consolidated returns must be filed. It is from this ruling that the companies have appealed, on the ground that the interests of husband and wife are separate and distinct; that no partnership existed between husband and wife as to property ownership and that because of the wide disparity of stockholdings of the individuals in each of the three corporations, consolidated returns should not be required.

**1278** Under the old common-law rules it appears that a husband and wife were considered as one and the same, but within the past few years the rights and liabilities of husband and wife have undergone vast changes, particularly in some States. This has been brought about partly by the courts and partly by the State legislatures, the general effect of which has been to secure to the wife the right of independent control of her own property and the right to contract, sue, and be sued without her husband, under certain restrictions.

**1279** The Committee has examined the statutes of the State of Wisconsin, where the corporations in question and all of the individual stockholders are domiciled.

**1280** Section 2340 of the statutes provides:

The real estate of every description, including all held in joint tenancy with her husband, and the rents, issues and profits thereof of any female now married shall not be subject to the disposal of her husband, but shall be her sole and separate property as if she were unmarried.

**1281** Section 2341 of the statutes provides:

The real and personal property of any female who may hereafter marry and which she shall own at the time of marriage and the rents, issues and profits thereof shall not be subject to the disposal of her husband nor be liable for his debts and shall continue her sole and separate property.

**1282** Section 2342 of the statutes provides:

Any married female may receive by inheritance or by gift, grant, devise or bequest from any person, hold to her sole and separate use, convey and devise real and personal property and any interest or estate therein of any description, including all held in joint tenancy with her husband, and the rents, issues and profits thereof in the same manner and with like effect as if she were unmarried, and the same shall not be subject to the disposal of her husband nor be liable for his debts. Any conveyance, transfer or lien executed by either husband or wife to or in favor of the other shall be valid to the same extent as between other persons.

**1283** Section 2343 of the statutes provides:

The individual earnings of every married woman, except those accruing from labor performed for her husband, or in his employ or payable by him, shall be her separate property and shall not be subject to her husband's control or liable for his debts.

**1284** Section 2345 of the statutes provides that a married woman may sue in her own name, and shall have all the remedies of an unmarried woman in regard to her separate property or business, and to recover her earnings, and shall be liable to be sued in respect to her separate property or business, and judgments may be rendered against her and be enforced against her and her separate property in all respects as if she were unmarried.

**1285** Section 2346 of the statutes provides that a husband is not liable for the individual debts of his wife, but that she is liable therefor, as if she were unmarried.

**1286** A careful study of the facts in this case convinces the Committee of the clear independence of action of the four stockholders in these

companies in acquiring and disposing of their stock and it seems equally clear that the State statutes gave to them the right to such independence. The absence of any ulterior motive on the part of the stockholders has also been fully established.

**1287** The Committee, therefore, is of the opinion that because of the disparity of stockholdings of the stockholders in these three corporations the Bureau would be unable to compel the corporations to pay a tax based upon a consolidated return of net income unless the corporations voluntarily paid such tax, and that, therefore, consolidated returns in this case should neither be required nor permitted.

**1288** It is therefore recommended, in the appeal of the M Company, the O Company, and the P Company, that the ruling of the Income Tax Unit that these companies were affiliated and should file consolidated returns for the years 1917, 1918, and 1919, be reversed, and, accordingly, that the appeal be sustained. (I-26-373: A. R. R. 942.—June 1922 Cum. Bull. p. 298.)

(T. D. 3389.)

[*Note: This amendment of Arts. 77 and 78, of Regulations 41, 1917 Act, is in conformity with the provisions of Section 1331 of the Revenue Act of 1921 (§1079-1081). For reference purposes T. D. 2662 (March 6, 1918), as amended by T.D. 2901 (July 29, 1919), is produced below as a footnote (see page 462).—The Corporation Trust Company.*]

**1289** [1917 Act.] Articles 77 and 78, Regulations 41, amended, Treasury  
1079 Decision 2662, as amended by T. D. 2901, superseded.—Treasury  
1263 Decision 2662, as amended by Treasury Decision 2901, is hereby  
superseded and Articles 77 and 78, of Regulations 41, are hereby  
amended to read as follows:

**1290** Art. 77. When affiliated corporations or partnerships must furnish information as to intercompany relations.—For the purpose of the excess profits tax, every corporation or partnership will describe in its return all its intercompany relationships with other corporations and partnerships with which it is affiliated, and will furnish such information in relation thereto as will enable the Commissioner of Internal Revenue to compute the amount of the tax properly due from each corporation or partnership on the basis of an equitable and lawful accounting.

**1291** For the purpose of this Regulation a corporation or partnership is affiliated with one or more corporations or partnerships (1) when such corporation or partnership owns directly or controls through closely affiliated interests or by a nominee or nominees all or substantially all of the stock of the other or others, or (2) when substantially all of the stock of two or more corporations or the business of two or more partnerships is owned by the same interests and in both (1) and (2) it is found that (a) such corporations or partnerships are engaged in the same or a closely related business, or (b) one corporation or partnership buys from or sells to another corporation or partnership products or services at prices above or below the current market, thus effecting an artificial distribution of profits, or (c) one corporation or partnership in any way so arranges its financial relationships with another corporation or partnership as to assign to it a disproportionate share of net income or invested capital.

**1292** The owning or controlling of 95 per cent or more of the outstanding voting capital stock (not including stock in the treasury) at the begin-



ning of and during the taxable year will be deemed to constitute an affiliation within the meaning of the statute, provided the corporations or partnerships were engaged in the same or a closely related business or there were such inter-company transactions as are specified in clauses (b) and (c) in the preceding paragraph.

**1293 Art. 78. Consolidated returns.**—A consolidated return shall be filed by the parent or principal corporation or partnership in the office of the collector of the district in which it has its principal place of business or principal office. Each of the other affiliated corporations or partnerships shall file in the office of the collector of its respective district a return, entering thereon its name and address and replying to the questions in Schedule I, and to questions 1, 2, 3, 4 and 11 on page 4 of Form 1103; and stating also (1) that the corporation or partnership is affiliated with a designated parent or principal corporation or partnership, (2) that its return is included in the consolidated return of such parent or principal corporation or partnership, and (3) the district in which the consolidated return is filed. When corporations or partnerships required to file such consolidated return, neglect or refuse to do so, the Commissioner of Internal Revenue may cause an examination of the books of all such corporations or partnerships to be made and a consolidated statement to be made from such examination. In cases where consolidated returns are accepted, the total tax will be computed in the first instance as a unit upon the basis of the consolidated return and will be assessed upon the respective affiliated corporations and upon the partnerships in such proportions as may be agreed among them. If no such agreement is made, the tax will be assessed upon each such corporation and partnership in accordance with the net income and invested capital properly assignable to it.

**1294** When all, or substantially all of the stock of a subsidiary corporation was acquired for cash, the cash so paid shall be the basis to be used in determining the value of the property acquired. Where stock of a subsidiary company was acquired with the stock of the parent company, the amount to be included in the consolidated invested capital in respect of the company acquired shall be computed in the same manner as if the net tangible assets and the intangible assets have been acquired instead of the stock. If in accordance with such acquisition, a paid-in surplus is claimed, such claim shall be subject to the provisions of Articles 55 and 63 of Regulations 41.

**1295** Affiliated corporations or partnerships filing a consolidated return shall include in such return (1) a specific statement of the number or proportion of the shares in the affiliated corporations held by the parent or controlling corporation or partnership during the taxable year, and (2) a schedule showing the proportionate amount of the total tax which it is agreed among them is to be assessed upon each affiliated corporation or partnership.

**1296** Railroads, gas, electric, water and other public service corporations when (a) operated independently and (b) not physically connected or merged—particularly when situated in different jurisdictions and subject to regulation by public service commissions—will not be required or permitted, without special permission obtained in advance, to make a consolidated return. When, however, a railroad or other public utility is owned by an industrial corporation and is operated as a plant facility or as an integral part of a group organization of affiliated corporations, and such affiliated corporations are required to file a consolidated return, the return of

such railroad or other public utility shall be included therein. (T. D. 3389, August 24, 1922.)

T. D. 2662 (March 6, 1918) as amended by T. D. 2901 (July 29, 1919)

Pursuant to article 78 of regulations 41 relative to war excess-profits tax, affiliated corporations as limited and defined in paragraphs C and D below are hereby directed to make consolidated returns for the purpose of excess-profits tax. Affiliated corporations other than those falling within the provisions of paragraphs C and D may make a consolidated return only after having secured permission in writing from the Commissioner of Internal Revenue. Affiliated corporations are defined in article 77 of the regulations as follows:

For the purpose of this regulation two or more corporations will be deemed to be affiliated (1) when one such corporation owns directly or controls through closely affiliated interests or by a nominee or nominees, all or substantially all of the stock of the other or others, or when substantially all of the stock of two or more corporations is owned by the same individual or partnership, and both or all of such corporations are engaged in the same or a closely related business; or (2) when one such corporation (a) buys from or sells to another products or services at prices above or below the current market, thus effecting an artificial distribution of profits, or (b) in any way so arranges its financial relationships with another corporation as to assign to it a disproportionate share of net income or invested capital.

A. Two or more corporations are not "affiliated" merely because all or substantially all of the stock therein is owned by the same corporation, individual, or partnership; they must also be engaged in the same or a closely related business.

B. For purposes of regulation by public service commissions or similar authorities, the identity of public service corporations, when not grouped into one operating unit, must be maintained even though they are owned by the same corporation or taxpayer, and under such regulation the accounts of such public service corporations are deemed to reflect the true invested capital and income of each operating unit. Accordingly railroads, gas, electric, water and other public service corporations when operated independently and not physically connected or merged—particularly when situated in different jurisdictions and subject to regulation by public service commissions—will not be required or permitted without special permission obtained in advance to make a consolidated return. When, however, a railroad or other public utility is owned by an industrial corporation and is operated as a plant facility or as an integral part of a group organization of affiliated corporations, and such affiliated corporations are required to file a consolidated return, the return of such railroad or other public utility shall be included therein.

C. The words "all or substantially all of the stock" as used in the above definition (Art. 77) will, until further notice, be interpreted as meaning an ownership of 95 per cent or more of such stock by the same taxpayer during the taxable year.

D. In case of affiliated corporations among which there exist contracts or trade or financial practices which arbitrarily or artificially influence or determine the amount of the invested capital or net income of one or more of the corporations so affiliated and where 95 per cent or more of the stock of the subsidiary corporations is owned by a parent or controlling corporation or by an individual or partnership, a consolidated return will be required.

E. A consolidated return shall be filed by the parent or principal corporation in the office of the collector of the district in which it has its principal office. Each of the other affiliated corporations shall file in the office of the collector of its respective district a return, entering thereon its name and address and replying to the questions in Schedule I, and to questions 1, 2, 3, 4, and 11 on page 4 of Form 1103; and stating also (1) that the corporation is affiliated with a designated parent or principal corporation, (2) that its return is included in the consolidated return of such parent or principal corporation, and (3) the district in which the consolidated return is filed.

F. When all, or substantially all, of the stock of a subsidiary corporation was acquired for cash, the cash so paid shall be the basis to be used in determining the value of the property acquired. Where stock of a subsidiary company was acquired with the stock of the parent company, the amount to be included in the consolidated invested capital in respect of the company acquired shall be computed in the same manner as if the net tangible assets and the intangible assets had been acquired instead of the stock. If in accordance with such acquisition a paid in surplus is claimed, such claim shall be subject to the provisions of Articles 55 and 63 of Regulations 41.

G. Affiliated corporations filing a consolidated return shall include in such return (1) a specific statement of the number or proportion of the shares in the affiliated corporations held by the parent or controlling corporation during the taxable year, and (2) a schedule showing the proportionate amount of the total tax which it is agreed among them is to be assessed upon each affiliated corporation.

H. If the Commissioner of Internal Revenue upon examination of any consolidated return finds that the tax can not in his judgment be properly assessed upon the basis of such return, the affiliated corporations covered by such consolidated return shall, upon notice from the Commissioner of Internal Revenue, file separate returns.



## (Decision.)

Revenue Act of 1917.

## Application of the deduction in the computation of the tax.

## SUPREME COURT OF THE UNITED STATES

Greenport Basin and Construction Company, Plaintiff in Error, }  
 The United States. } In Error to and Appeal from the District Court of the United States for the Eastern District of New York.

[January 2, 1923.]

Mr. Justice BRANDEIS delivered the opinion of the Court.

**1297** The Greenport Company had, in 1917, an invested capital of \$215,615.55. Its net income was \$76,361.20 in the taxable year ending October 31, 1917. Its pre-war annual net income, calculated on a 7 per cent. basis was \$15,093.08; and the fixed statutory deduction \$3,000. The company was thus subject (for five-sixth of the year) to the excess profits tax imposed by the Revenue Act of October 3, 1917, c. 63, sections 201, 203; 40 Stat. 300, 303, 304.<sup>1</sup> The Government, following Treasury Regulation No. 41, Articles 16, 17, and form 1103, assessed the tax at \$16,837.76. The company insisted that the correct amount was \$12,417.36; paid the tax as assessed, under protest; and brought this suit for the difference, \$4,420.40, in the federal court for the Eastern District of New York, under the Tucker Act. (Judicial Code, Sec. 24, Par. 20.) That court sustained a demurrer to the petition and entered judgment for defendant. 269 Fed. 58. The case is brought here by both writ of error and appeal. It is properly here on writ of error, *Chase v. United States*, 155 U. S. 489; *J. Homer Frich, Inc. v. United States*, 248 U. S. 458. The sole question presented for decision is whether the method of calculating the taxes adopted by the Treasury is in harmony with the provisions of the Revenue Act.

**1298** The rate of exaction imposed by the excess profits tax grows, in stages, with the increase in the percentage earned on the capital. In the first stage—net income up to 15 per cent. on capital—the rate of exaction is four-twentieth. In the second stage—net income from 15 to 20 per cent.—the rate is five-twentieth. In the third stage—net income from

<sup>1</sup>Section 201: "That in addition to the taxes under existing law and under this act there shall be levied, assessed, collected, and paid for each taxable year upon the income of every corporation, partnership, or individual, a tax . . . equal to the following percentages of the net income:

"Twenty per centum of the amount of the net income in excess of the deduction (determined as hereinafter provided) and not in excess of fifteen per centum of the invested capital for the taxable year;

"Twenty-five per centum of the amount of the net income in excess of fifteen per centum and not in excess of twenty per centum of such capital;

"Thirty-five per centum of the amount of the net income in excess of twenty per centum and not in excess of twenty-five per centum of such capital;

"Forty-five per centum of the amount of the net income in excess of twenty-five per centum and not in excess of thirty-three per centum of such capital; and

"Sixty per centum of the amount of the net income in excess of thirty-three per centum of such capital."

Section 203: "That for the purposes of this title the deduction shall be as follows, except as otherwise in this title provided:

"(a) In the case of a domestic corporation, the sum of (1) an amount equal to the same percentage of the invested capital for the taxable year which the average amount of the annual net income of the trade or business during the prewar period was of the invested capital for the prewar period (but not less than seven or more than nine per centum of the invested capital for the taxable year), and (2) \$3,000."

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WAR TAX 463 SERVICE

JAN 10 1923

## WAR-PROFITS AND EXCESS-PROFITS TAX REGULATIONS, ETC.—1922-1923.

20 to 25 per cent.—the rate is seven-twentieth. In the fourth stage—net income from 25 to 33 per cent.—the rate is nine-twentieth. In the last stage—net income over 33 per cent.—the rate is twelve-twentieth. What the net income is to which the respective rates of exaction apply is the question for decision. The company contends, in effect, that net income as used concerning each stage, means not the whole net income—but the balance remaining after deducting from the net income the allowance for prewar profits and the fixed deduction. Under this contention the base to which the exactions should be applied would be, not \$76,261.20, but that sum less \$18,093.08, or \$58,268.12. The Government insists that the exaction should be applied to the whole net income, except that from the exaction prescribed for the first stage the allowances specifically provided for are to be deducted.<sup>2</sup> The differences in detail resulting from the two methods of calculation are shown in the margin.<sup>3</sup>

**1299** The method of calculation adopted by the Treasury follows the clear language of the act; and its correctness is confirmed by the statement, and the illustrative tables, presented by the chairman of the Ways and Means Committee in submitting the Conference Report on the bill. Cong. Record, 65th Congress, 1st Session, Part 7, pp. 7580-7593. As the language of the act is clear, there is no room for the argument of plaintiff drawn from other revenue measures. Nor is there anything in *La Belle Iron Works v. United States*, 256 U. S. 377, 383-388 [¶889, herein], which lends support to plaintiff's contention.

*Affirmed.*

<sup>2</sup>Treasury Regulation No. 41, Article 17, provided that if the deduction exceeded 15% of the invested capital the amount in excess should be applied to the next succeeding tax bracket and so on until the deduction should be absorbed. Compare Section 301(d) Act of February 24, 1919, c. 18, 40 Stat. 1057, 1089.

<sup>3</sup>Methods of Computation.

I. GOVERNMENT'S METHOD.

First, apportion the net income into the tax brackets:

Percentages of invested capital	Amount
(1) 0 to 15%	\$32,342.33
(2) 15% to 20%	10,780.77
(3) 20% to 25%	10,780.77
(4) 25% to 33%	17,249.24
(5) Above 33%	5,208.09

Total net income..... \$76,361.20

Second, apply the deduction to the first tax bracket:

(1) \$32,342.33 minus \$18,093.08 leaves \$14,249.25.

Third, compute the tax:

(1) \$14,249.25 at 20%	\$2,849.85
(2) \$10,780.77 at 25%	2,695.19
(3) \$10,780.77 at 35%	3,773.27
(4) \$17,249.24 at 45%	7,762.15
(5) \$ 5,208.09 at 60%	3,124.85

\$58,268.12 Total tax.... \$20,205.31

Pro rate (5/6)..... \$16,837.76

II. PLAINTIFF'S METHOD

First, apply the deduction:

\$76,361.20 minus \$18,093.08 leaves \$58,268.12 as taxable income

Second, apportion the taxable income into the tax brackets:

Percentages of net income as portion of invested capital	Amount
(1) 0 to 15%	\$32,342.33
(2) 15% to 20%	10,780.77
(3) 20% to 25%	10,780.77
(4) 25% to 33%	4,364.25
(5) Above 33%	none

Total taxable income..... \$58,268.12

Third, compute the tax:

(1) \$32,342.33 at 20%	\$6,468.47
(2) \$10,780.77 at 25%	2,695.19
(3) \$10,780.77 at 35%	3,773.27
(4) \$ 4,364.25 at 45%	1,963.91
(5) none at 60%	none

\$58,268.12 Total tax..... \$14,900.84

Pro rate (5/6)..... \$12,417.36



(Decision.)

Revenue Act of 1917.

February 5, 1923.

**Additions to surplus account: Earned surplus expended in developing and improving a secret process, or used to repay borrowed money so expended.**

UNITED STATES CIRCUIT COURT OF APPEALS  
FOR THE SECOND CIRCUIT.

LINCOLN CHEMICAL COMPANY, Plaintiff-in-Error (Plaintiff below),  
against

WILLIAM H. EDWARDS, as Collector of Internal Revenue of the United States  
for the Second District of New York, Defendant-in-Error  
(Defendant below).

Before

ROGERS, MANTON AND MAYER, Circuit Judges.

ROBERT B. HONEYMAN, For Plaintiff.

WILLIAM HAYWARD, United States Attorney, For Defendant,

RICHARD S. HOLMES, Special Assistant U. S. Attorney,

H. M. DARLING, Special Attorney, Bureau of Internal Revenue, Of Counsel.

*This cause comes here on writ of error to the United States District Court for the Southern District of New York.*

**1300** ROGERS, Circuit Judge.—This action was brought by a New York corporation against the Collector of Internal Revenue in the Second District of New York to recover the sum of \$6,434.35 additional income and excess profits tax assessed by the Commissioner of Internal Revenue for the fiscal year ending December 31, 1917, which was paid under protest on April 9, 1919. It is alleged that the payment was made under compulsion and in order to avoid the restraint and sale of plaintiff's property and other legal proceedings. And it appears that on May 2, 1919, the plaintiff filed a claim for refund, and that although six months had elapsed since the filing of the claim for a refund no action had been taken by the Commissioner.

**1301** The case was tried before a jury of one. At the conclusion of the testimony each side moved for a direction of a verdict. The court, after taking time for deliberation, filed an opinion stating that the plaintiff had not proved its case and directed a verdict for the defendant, dismissing the complaint upon the merits. [272 Fed. 142.—¶926 herein.]

**1302** The plaintiff, in filing its return for 1917, calculated its capital upon the basis of Section 209 of the Act of October 3, 1917. That Section provides as follows:

"That in the case of a trade or business having no invested capital or not more than a nominal capital there shall be levied, assessed, collected and paid, in addition to the taxes under existing law and under this Act, in lieu of the tax imposed by section two hundred and one, a tax equivalent to eight per centum of the net income of such trade or business in excess of the following deductions: In the case of a domestic corporation \$3,000, and in the case of a domestic partnership or a citizen or resident of the United States \$6,000; in the case of all other trades or business, no deduction." (U. S. St. at L. vol. 40, Part 1 p. 307.)

**1303** That section applies to a trade or business "having no invested capital or not more than a nominal capital." If the plaintiff in 1917 had no invested capital or not more than a nominal capital its income tax return plainly was to be assessed, as the plaintiff claims, in accordance with Section 209.

**1304** The Commissioner of Internal Revenue, however, denied the claim that the assessment could be made under Section 209, and imposed an additional assessment in the amount hereinbefore mentioned of \$6,434.35. This he did under Section 210 of the Act, which may be found in the margin.\*

**1305** In thus proceeding the Commissioner over-ruled the plaintiff's contention that it had no invested capital, or not more than a nominal capital, and held that the case was one in which the officials were unable satisfactorily to determine the invested capital and so came within the provisions of Section 210, and Article 52 of Regulations 41 [see Art. 911 of Reg. 45, ¶1832], which provide in such exceptional cases for assessment based on a comparison with representative concerns engaged in a like or similar business.

**1306** In determining whether the plaintiff's claim is correct it is necessary to examine into the facts to ascertain what basis there is for the claim that the plaintiff was in 1917 a corporation without an invested capital, or no more than a nominal capital.

**1307** The plaintiff is conceded to be a corporation having an authorized capital stock of \$10,000, all of which is issued and outstanding. At the beginning of the year 1917 its only assets appear to have been cash variously estimated at \$7,367.64, and \$11,017.83, together with a secret process for extracting theobromine, a valuable drug, from cocoa shells.

**1308** The process referred to had been acquired by the corporation in 1909, at the time of its organization, by the issue of \$2,400 par value of its capital stock to one Robert Riddle. The balance of the stock, \$7,600 par value, had been issued at the same time to Herman A. Loeb, in exchange for plant, machinery, raw materials, etc., and \$200 in cash. Riddle and Loeb thus acquired all the stock and were the only persons who were financially interested in the company. Riddle was an inventor and before the incorporation took place came to Loeb with a process for extracting cocoa butter out of cocoa shells. The process having been shown to be worthless Riddle suggested to Loeb the possibility of converting the process into one from which there might be extracted from cocoa shells a substance known as theobromine, a chemical substance allied to caffeine. Loeb continued to advance money to Riddle to aid him in further experiments, until he became afraid that he was getting too deeply involved, and he determined to form a corporation to carry on the work. Thereupon they formed the corporation—Riddle transferring to it the process and agreeing to work for the company for five years at a salary of \$1,800. The stock of the company was issued to Riddle and Loeb in the amounts and for the reasons already stated.

\*Sec. 210. That if the Secretary of the Treasury is unable in any case satisfactorily to determine the invested capital, the amount of the deduction shall be the sum of (1) an amount equal to the same proportion of the net income of the trade or business received during the taxable year as the proportion which the average deduction (determined in the same manner as provided in section two hundred and three, without including the \$3,000 or \$6,000 therein referred to) for the same calendar year of representative corporations, partnerships, and individuals, engaged in a like or similar trade or business, bears to the total net income of the trade or business received by such corporations, partnerships, and individuals, plus (2) in the case of a domestic corporation \$3,000, and in the case of a domestic partnership or a citizen or resident of the United States \$6,000."



**1309** It appears that in the years 1909 and 1910 the company borrowed \$19,716.84 of which amount \$19,314.07 was obtained from Loeb and his relations. This money was borrowed by the corporation and expended by it in the improvement of the process. And by April, 1910, the process was successfully worked out. But the corporation was unable to secure the means to carry on the work, and it resulted that it sold its machinery and stock on hand for \$1,563.49, and entered into a license agreement with the Schaefer Alkaloid Works of Maywood, New Jersey, under which agreement the licensee was to use the process, paying the corporation a royalty for the privilege. This agreement was later replaced by a second agreement dated June 20, 1912, under which the licensee agreed to pay the corporation a fixed royalty of \$2,000 a year for the use of the process, and to sell to the corporation such quantities of theobromine as it might order at a price not to exceed \$2.50 per pound. During the Great War the price of theobromine rose and the affairs of the plaintiff corporation prospered. It was in a short time able not only to pay the interest on its indebtedness but from time to time it made payments on account of the principal. And by January 1, 1917, all of the money borrowed had been repaid out of the earnings of the company. Throughout that year the corporation paid its officers liberal salaries and earned a net income of \$26,850.12, all of which, with the exception of \$45.18 interest, was derived from the process and the contract with the Schaefer Alkaloid Works. On January 1, 1917, the company, having all its debts paid, had a surplus of \$13,000 after writing off a depreciation of \$7,700. During the year 1917 its assets consisted of the secret process, its contract with the Schaefer Alkaloid Works, and its cash on hand.

**1310** The case depends upon the meaning of the phrase "invested capital" and "nominal capital" as used in Section 209 of the Act. What is to be deemed "invested capital" is set forth in Section 207, both Sections being under Title 2 of the Act. The pertinent part of Section 207 may be found in the margin.\*

\*"Sec. 207. That as used in this title, the term 'invested capital' for any year means the average invested capital for the year, as defined and limited in this title, averaged monthly.

As used in this title 'invested capital' does not include stocks, bonds (other than obligations of the United States), or other assets, the income from which is not subject to the tax imposed by this title nor money or other property borrowed, and means, subject to the above limitations:

(a) In the case of a corporation \* \* \* (1) Actual cash paid in, (2) the actual cash value of tangible property paid in other than cash, for stock, or shares in such corporation \* \* \* at the time of such payment, 'but in case such tangible property was paid in prior to January first, nineteen hundred and fourteen, the actual cash value of such property as of January first, nineteen hundred and fourteen, but in no case to exceed the par value of the original stock or shares specifically issued therefor and (3) paid in or earned surplus and undivided profits used or employed in the business, exclusive of undivided profits earned during the taxable year: Provided, That \* \* \* (b) \* \* \* intangible property shall be included as invested capital if the corporation \* \* \* made payment bona fide therefor specifically as such in cash or tangible property, the value of such \* \* \* intangible property, not to exceed the actual cash or actual cash value of the tangible property paid therefor at the time of such payment; but \* \* \* intangible property, bona fide purchased, prior to March third, nineteen hundred and seventeen, \* \* \* for and with shares in the capital stock of a corporation (issued prior to March third, nineteen hundred and seventeen), in an amount not to exceed, on March third, nineteen hundred and seventeen, twenty per centum of the total \* \* \* shares of the capital stock of the corporation, shall be included in invested capital at a value not to exceed the actual cash value at the time of such purchase, and in case of issue of stock therefor not to exceed the par value of such stock; \* \* \* ."

**1311** Section 207 of the Act received the consideration of the Supreme Court in *La Belle Iron Works v. United States*, 256 U. S. 377. Mr. Justice Pitney, writing for the court in that case, said [¶897 herein]:

"The word 'invested' in itself imports a restrictive qualification. When speaking of the capital of a business corporation or partnership, such as the act deals with, 'to invest' imports a laying out of money, or money's worth, either by an individual in acquiring an interest in the concern with a view to obtaining income or profit from the conduct of its business, or by the concern itself in acquiring something of permanent use in the business; in either case involving a conversion of wealth from one form into another suitable for employment in the making of the hoped-for gains. See Webster's New Internat. Dict., 'invest' 8; Century Dict., 'invest' 7; Standard Dict., 'invest' 1.

In order to adhere to this restricted meaning and avoid exaggerated valuations, the draftsman of the act resorted to the test of including nothing but money, or money's worth, actually contributed or converted in exchange for shares of the capital stock, or actually acquired through the business activities of the corporation or partnership (involving again a conversion) and coming in ab extra, by way of increase over the original capital stock."

**1312** The construction given to an Act of Congress, by a Department of the Government charged with its execution, is not controlling upon the courts as the Department is not authorized to exercise the judicial function, but it is entitled to great consideration when the meaning of a statute is doubtful. *United States v. Hermanos y Compania*, 209 U. S. 337, 339; *United States v. Healey*, 160 U. S. 136; *Robertson v. Downing* 127 U. S. 607. And the consideration given to such construction is particularly weighty in the case of statutes levying impositions where the construction had been favorable to the persons affected. *State v. Orleans Parish Bd. of Assessors*, 52 La. Ann. 223; *Attorney General v. Newbern* 21 N. C. 216.

**1313** The Regulations of the Commissioner of Internal Revenue No. 45, Article 840 [¶764], shows the understanding of the Department that amounts expended for improvements in tangible property such as plant, equipment and the like are to be added to the surplus account if such assets are in active use by the corporation. And Article 841 [¶769] shows that expenses in the development of intangible property are to be added to surplus account unless the taxpayer has seen fit to charge such expenditures to current expenses. And see Article 843 [¶773] of the same Regulations.

**1314** And in the Recommendation of the Committee on Appeals and Review No. 115 (unreported) it was held that a manufacturing company which spent \$2,400,000 of its current earnings before 1909 in the development of a trade name, and charged this amount to capital account, was entitled to include this amount in its invested capital under the excess profits tax law.

**1315** So also in Recommendation of the Committee on Appeals and Review No. 134 (Digest of Income Tax Rulings No. 19, page 460: Cumulative Bulletin 5-1719 [Sec. 326, Art. 831-17, ruling No. 25, in Supplementary Bulletin Rulings herein]), the Committee stated that it was

"of the opinion that a corporation should be allowed as invested capital for the taxable year 1917 the full amount expended by it in cash and capitalized prior to 1909, as a part of the cost of developing certain intangible assets, which it had acquired for stock and cash."



**1316** It must be admitted that if the corporation can show that on January 1, 1917, it had no "invested capital" or not more than a "nominal capital" within the meaning of Section 209 it was entitled to be assessed under that section. We think it clearly appears that at the time above mentioned the company had some invested capital and therefore was not entitled to be assessed under the Section referred to.

**1317** When the plaintiff was incorporated in 1909 it had an authorized capital stock of \$10,000 all of which it issued. This stock, as already shown, was issued for \$200 in cash and the remainder for property. The property it received was the secret process for which it paid in stock \$2,400 in par value, and machinery and supplies for which it paid in stock \$7,400 in par value. Its capital at that time consisted of tangible and intangible property. Its intangible property consisted of the secret process. But all the invested capital in the form of cash and tangible property paid in for stock had disappeared by 1917. Its only assets in 1917 were the secret process and the cash it had on hand, which is variously estimated at \$7,367.64 and \$11,017.83. The company, however, had expended prior to 1917, to improve its process, \$19,314.01. This it did by borrowing monies which it repaid out of its earnings in the years 1914, 1915 and 1916. There is no evidence in the record that these expenditures were ever treated as a current expense. The money used in improving the process is not found in its surplus but the company still has the improvements and the improvements constitute surplus to the extent of their value, and as these expenditures were made to improve the process which the company used in its business, it has an invested capital in the amount expended.

**1318** The case is not unlike, in principle, that of a company which finds it necessary to enlarge or improve its plant. If it is without the necessary capital to make the improvement it borrows the money and repays it out of its earnings. In so doing its earnings so paid have disappeared from its surplus but the improvements made to the plant take the place of the surplus expended and constitute a part of the invested capital.

**1319** That the prosperity of the company according to its own opinion was built upon the process and the improvements made therein appears from a resolution adopted by its directors on January 9, 1917, in which they refer to the services given by Riddle and Loeb "to the development of the process owned by this company, to which processes this company owes its present prosperity."

**1320** And it is not without interest that in the Income Tax return, which the company made in 1916, it declared that the fair market value of the process was \$19,716.84 and claimed a deduction for depreciation for all years to date of \$7,761.42. This left the value of the process at the beginning of the year, 1917, at about \$12,000.

**1321** The contention of the appellant corporation is that in the year 1917 the taxes due from it were to be computed under section 209 inasmuch as while the corporation originally had invested capital in the form of cash and tangible property paid in for stock, this had all disappeared prior to that year and therefore could not be included in invested capital at that time. It claims that its only assets then were the secret process and cash representing profits of the previous year. As to the process it was not improved but was incomplete at the time of its acquisition when it had only a nominal cash value. And reliance is placed on Section 208 3(b) which declares that intangible property bona fide purchased prior to March 3, 1917, with shares in the capital stock in an amount not to exceed 20 per centum

of the total shares of the capital stock 'shall be included in invested capital at a value not to exceed the actual cash value at the time of such purchase, and in case of issue of stock therefor not to exceed the par value of such stock.'"

**1322** The fallacy of the argument is in the assumption that the limitation placed by section 207 upon the amount at which intangible property paid in for stock may be included in invested capital applies merely to the original investment for the stock and that subsequent improvements of such assets are to be disregarded.

**1323** The case of *La Belle Iron Works v. United States*, supra, holds that under Section 207 appreciated valuations of assets *above costs* are not to be included in "invested capital." That phrase cannot be applied to any appreciation in values which is not in substance and effect a new acquisition of capital property by the company. "Invested capital" is based upon actual costs and does not embrace appreciations in value due to the "unearned increment." In the *La Belle Iron Works* case ore lands originally acquired by the corporation for \$190,000 were proved by extensive explorations and developments to have a cash value of \$10,105,400. The court, referring to this said it assumed that the *cost* of the *exploration and development* work might be regarded as earned surplus. The court said:

"It is said that the admitted increase in the value of appellant's ore lands is properly to be characterized as earned surplus, because it was the result of extensive exploration and development work. We assume that a proper sum, not exceeding the cost of the work, might have been added to earned surplus on that account; but none such was stated in appellant's petition, nor, so far as appears, in its return of income. In the absence of such a showing it was not improper to attribute the entire \$9,915,400, added to the book value of the ore property in the year 1912, to a mere appreciation in the value of the property; in short, to what is commonly known as the 'unearned increment,' not properly 'earned surplus' within the meaning of the statute."

**1324** But in 1917 the process was not the only asset which the plaintiff possessed. It also had on hand cash which it had acquired solely through the accumulation of earnings. Whether it amounted to \$11,017.83 as claimed or only \$7,367.64 is not material so far as the question now presented is concerned. In any event its surplus was substantial and cannot be considered as merely nominal.

**1325** The contract which the plaintiff has with the Schaefer Alkaloid Works and under which the plaintiff is entitled to receive a minimum royalty of \$2,000 a year with the right to call yearly for at least 3,000 pounds of theobromine at \$2.50 a pound and which had ten years longer to run need not be considered at this time. It manifestly cannot help the plaintiff's case.

**1326** As the plaintiff was not engaged in business "having no invested capital or not more than a nominal capital" its contention that it was entitled to be assessed under Section 209 and not under Section 210 is without merit and is denied.

*Judgment Affirmed.*



## (Decision.)

## 1917 Tax on Individuals.

**1327 Commissions on certain renewal insurance premiums.**—[Comment:

In *Woods vs. Lewellyn*, Collector, U. S. District Court for the Western District of Pennsylvania (No. 2630, November Term, 1921), decided March 14, 1923, Judge Gibson holds that commissions received by Mr. Woods in 1917 on renewal premiums on insurance, previously written by him were not to be included in income subject to excess-profits tax under the existing circumstances, the facts being: The insurance was written by Mr. Woods during the time he was acting as General Agent of the Equitable Life Assurance Company; he had ceased to be such at the beginning of 1917; during all of 1917 he was president and manager (at a salary of \$30,000) of an incorporated life insurance agency known as the Edward A. Woods Agency, which acted as General Agent of the Equitable Life Assurance Company; Mr. Woods had not transferred to the corporation his rights in the renewal commissions; he earned during 1917 \$2,787.33 in commissions on insurance written by him personally, and claimed as a business-expense deduction, personally, \$4,600. The court holds that the business engaged in by Mr. Woods was that of acting as president and manager of the corporation; that his earnings during the year from insurance written personally, were so small, as compared with his salary, as not to constitute earnings from a regular trade or business, but rather as earnings from more or less isolated transactions; that the expenses might well have been due to the exercise of an incidental or isolated activity; and that thus, not being engaged in the business of writing insurance, the renewal commissions received by Mr. Woods did not constitute income from his trade or business. In conclusion the court says: "As heretofore stated, it is our opinion that the sums sought by the Collector to be subjected to taxation as excess profits were not earned by plaintiff in the exercise of the vocation pursued by him in 1917, and were not rightfully collected. It is needless, therefore, for us to consider the forcible argument of counsel for plaintiff to establish the claim that the renewal premiums in question were 'the income from property arising merely from ownership, including interest, rent, and similar income from investments,' and as such declared not the subject to the excess profits tax by Article 8 of Regulation No. 41, issued by the Commissioner of Internal Revenue. Counsel has pointed out the fact that plaintiff would have received these premiums if he had retired from business altogether prior to 1917, and that they would have been paid to his heirs had he died in the latter part of 1916. This makes it plain, he claims, that the sums received by him as premiums, constituted income derived from property rights acquired prior to 1917, and not the fruits of his vocation or 'trade or business' in that year. His contention in this respect is doubtless worthy of serious consideration, in case the necessity for such consideration were to arise."—The Corporation Trust Company.]

WAR-PROFITS AND EXCESS-PROFITS TAX REGULATIONS, ETC.—1922-1923.

(Decision.)

*Revenue Act of 1917—War Excess-Profits Tax.*

July 5, 1923.

A corporation whose entire income is derived from royalties on patents in which it has no investment is entitled to assessment under Section 209 as being engaged in a trade or business having no invested capital or not more than a nominal capital.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.  
Samuel Iredell, Collector of Internal Revenue of the United States for the First District of New Jersey.

Plaintiff in Error,

vs.

De Laski and Thropp Circular Woven Tire Company,  
Defendant in Error.

*In Error to the District Court of the United States for the District of New Jersey.*  
Before BUFFINGTON, WOOLLEY and DAVIS, Circuit Judges.

**1328** BUFFINGTON, Circuit Judge.—In the Court below, the plaintiff 913 brought suit and recovered a judgment against Samuel Iredell, Collector, for taxes paid under protest, whereupon the Collector sued out this writ of error. His contention is that the taxes in question were assessable under Section 201 of the Revenue Act of 1917, while that of the plaintiff is that they were assessable under Section 209. The Court below sustained this latter contention and we agree with its view.

**1329** That Court, in an opinion reported at 268 Fed. 377 [¶913], had theretofore considered these two sections on a motion to dismiss the case and refused the same.

**1330** Trial by jury was subsequently waived and the case was tried by the Judge, who found the facts as printed in the margin\*, a consideration of which, together with the opinion referred to, renders needless present re-statement.

**1331** As we have said, we are of opinion the facts of this case clearly bring the plaintiff company under the provisions of Section 209. It was,

\*4. In the year 1911, the stockholders of the plaintiff formally decided not to engage in the business of manufacturing tires and determined that no further effort would be made to conduct any business other than that of granting licenses under its patents, and on July 19, 1911, the authorized capital stock of the company was reduced from \$100,000 to \$10,000 and the purpose clauses of its charter were appropriately amended. The plaintiff has never manufactured molds or tires or anything else and has no facilities to conduct a manufacturing business.

5. Between 1911 and December 31, 1916, several patents relating to tire manufacturing apparatus were granted to the officers of the plaintiff who in turn assigned them to the plaintiff for the consideration of \$1.00 each.

6. During the year 1917, the plaintiff's net income amounted to \$105,550.29, all of which was received under license agreements to use its patented apparatus, which have been the only source of income to plaintiff since its incorporation.

\* \* \* \* \*

8. During the year 1917, plaintiff's capital and surplus were \$10,000 and \$2,000 respectively, or a total invested capital of \$12,000 which nominal capital was purely



as provided by the Section, engaged in a trade or business having a nominal capital. It was not a producer or manufacturer but its entire business was simply to collect and distribute the rental or royalty charged for use of its patents and, as it may, in accordance with said Section, be assessed with "a tax equivalent to eight per centum of the net income of such trade or business" it follows by the terms of the section this shall be "in lieu of the tax imposed by section two hundred and one."

**1332** The Court below having found as a fact—a finding in which we concur—that the trade or business of the Plaintiff had no invested capital, and such being the plain wording of the statute, it follows that an attempt by departmental construction to theoretically swell that nominal capital into a large amount, simply because its business on its nominal capital proved highly remunerative, is at variance with the taxing statute and with the principle that the right to impose taxation must have clear statutory warrant and that doubtful constructions must be resolved in favor of the taxpayer.

*The judgment below is affirmed.*

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(Decision.)

1917 Tax on Individuals.

**1333** Failure to make and file separate excess profits tax return under the Act of October 3, 1917, subjects taxpayer to fifty per cent penalty.

—[Comment: In *Beam vs. Hamilton*, Collector, Circuit Court of Appeals, Sixth Circuit (289 Fed. 9), decided May 15, 1923, the plaintiff seeks to have set aside a judgment rendered in favor of the collector in a suit to recover a penalty (50% of the excess profits tax found due) for alleged failure to make separate return for excess profits tax purposes of income from his personal business as a distiller received during 1917 no accounting of which was carried forward in his income tax return of salary and dividends otherwise received. Judge Knappen held that " \* \* \* we are unable to agree with plaintiff's contention that, because Schedule B was so left blank, and plaintiff thereby (implied only) made a return that he was not engaged in a business with invested capital, and that he did not owe any excess profits tax, he thereby made a return within the meaning of the excess profits title, although the return so impliedly made on Form 1040 was untrue; nor with the further contention that, unless the return actually made was willfully false or fraud-

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incidental to the conduct of the plaintiff's business and was used entirely as a fund from which to advance salaries, wages, etc., and to provide office furniture, accommodations and equipment.

10. In compliance with the provisions of the Act of Congress entitled 'An Act to Provide Revenue to Defray War Expenses and other Purposes,' approved October 3, 1917, plaintiff made due returns to the defendant of its annual net income for the twelve (12) months ended December 31, 1917, and paid the income and excess profits taxes due thereunder, in accordance with the provisions of Section 209 of the said Act, whereby the excess profits tax was levied and assessed upon corporations employing no invested capital or not more than a nominal capital. The plaintiff's contention in this respect was disallowed by the Commissioner of Internal Revenue, and after various letters had been exchanged and a hearing had in Washington, the plaintiff was notified by the defendant in August, 1919, that additional income and excess profits taxes for the year 1917 had been assessed against it in the sum of \$16,969.45, which amount had been arrived at upon the basis of a fictitious capital constructed under Section 210 of the said Act and an application of the rates prescribed by Section 201 of the Act for corporations employing capital."

**WAR-PROFITS AND EXCESS-PROFITS TAX REGULATIONS, ETC.—1922-1923.**

ulent, as the court below found it was not, plaintiff cannot be subject to the penalty for failure to make another return, as to which the liability is not conditioned upon fraudulent action. Not only was the excess profits tax a separate, distinct, and then novel source of revenue, but the statute and regulations \* \* \* in express and formal terms required separate and distinct returns thereof, and we think it clear that failure to make a separate return of excess profits tax is none the less a failure to make the return contemplated by the statute because of the mere fact that the computations on the excess profits return are to be carried onto Form 1040; the use of that form also is necessary to a complete report. By section 213 the Commissioner was undoubtedly given authority, with the approval of the Secretary of the Treasury, to require both returns. \* \* \* We think the Commissioner justified in holding that, while the accountant was responsible for the correctness of the figures, plaintiff was responsible for the source of the same and sufficient details to insure a complete understanding of the business, and that failure to take such precaution to 'discover the omission of the principal item of income' does not 'constitute reasonable cause for failure to file an excess profits tax return, which was also due to the omission of the income in question from [plaintiff's] income tax return.' The penalty, while drastic, was intended to insure payment of public revenue. No question of its reasonableness is involved."—The Corporation Trust Company.]

[The opinion in *Beam vs. Hamilton*, ¶1333 above, has been embodied in T. D. 3519, dated September 20, 1923. Opinion reported in full in Internal Revenue Bulletin No. 26 of the 1923 Series, page 9.]



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# CAPITAL STOCK TAX--1921 ACT

OR

SPECIAL EXCISE TAX ON CORPORATIONS.

BEING PART OF TITLE X OF THE REVENUE ACT OF 1921.

In effect on and after July 1, 1922.

**Return:** To be filed during July (on or before July 31) each year.

**Tax:** To be paid within 10 days after notice and demand. See ¶3088.

**3000** Sec. 1000 [of Title X of the Revenue Act of 1921]. (a) That on and after July 1, 1922, in lieu of the tax imposed by section 1000 of the Revenue Act of 1918—

## [Domestic Corporations.]

**3001** (1) Every domestic corporation shall pay annually a special excise tax with respect to carrying on or doing business, equivalent to \$1 for each \$1,000 of so much of the fair average value of its capital stock for the preceding year ending June 30 as is in excess of \$5,000. In estimating the value of capital stock the surplus and undivided profits shall be included;

## [Foreign Corporations.]

**3002** (2) Every foreign corporation shall pay annually a special excise tax with respect to carrying on or doing business in the United States, equivalent to \$1 for each \$1,000 of the average amount of capital employed in the transaction of its business in the United States during the preceding year ending June 30.

## [Exempt Corporations.]

**3003** (b) The taxes imposed by this section shall not apply in any year to any corporation which was not engaged in business (or, in the case of a foreign corporation, not engaged in business in the United States) during the preceding year ending June 30, nor to any corporation enumerated in section 231 [for list of exempt corporations read at ¶3063], nor to any insurance company subject to the tax imposed by section 243 or 246.

## [Secrecy of Returns.]

**3004** (c) Section 257 [of Title II, "Income Tax," of the Revenue Act of 1921] shall apply to all returns filed with the Commissioner for purposes of the tax imposed by this section. [See ¶3086.]

## [General Administrative Provisions of Law.]

[Read under "Miscellaneous" at the back of the book.]





Form 707  
U. S. INTERNAL REVENUE1924 RETURN  
CAPITAL STOCK TAXFOR DOMESTIC CORPORATIONS  
(SEC. 1000, REVENUE ACT OF 1921)TO BE STAMPED BY COLLECTOR SHOWING  
DISTRICT AND DATE RECEIVEDFile with Collector of Internal Revenue for your district  
on or before July 31, 1923, to avoid penalty.(Collection district.)  
Assessment List, Form 23 A.(Month) (Year)  
(Page) (Line)  
Audited by:

1. Name ..... (Print name of corporation, joint-stock company, or association.) (Show former name, if changed.)
2. Address ..... (The address must be that of the principal place of business. Give "Street and number," "City or town," and "State.")
3. Name of parent company, if any ..... (District filed .....)
4. Name of subsidiary, if any ..... No. shares held ..... (District filed .....)
5. Nature of business in detail .....
6. Incorporated or organized in State of ..... Month ..... Year .....
7. Return for previous year filed in ..... District. Fire insurance carried, if any, \$ ..... (As of date, Exhibit A.)

## TAX PAYABLE ANNUALLY IN ADVANCE

RETURN FOR TAXABLE PERIOD JULY 1, 1923, TO JUNE 30, 1924, BASED ON FAIR AVERAGE VALUE OF CAPITAL STOCK FOR PRECEDING YEAR  
CAREFULLY READ ALL INSTRUCTIONS BEFORE MAKING RETURN

JUNE 30, 1923. (Use no other date.)	Cum. or noncum.	Dividend rate.	Number of shares.	Par value per share.	TOTAL.				This column for use of Department.			
8. Common stock outstanding		%		\$	\$							
9. First preferred stock outstanding		%										
10. Second prefer'd stock outstanding		%										
11. Surplus (estimate if necessary)												
12. Undivided profits (estimate if necessary)												
13. TOTAL												

## COMPUTATION OF TAX

This column for use of  
taxpayer.This column for use of  
Department.

14. Fair value of total capital stock for fiscal year determined by Exhibit	\$											
15. Deduction allowed by law						5 0 0 0					5 0 0 0	
16. Amount in excess of \$5,000 ..... (Omit cents)												
17. Tax at rate of \$1 for each full \$1,000 in excess of \$5,000 ..... (Omit cents)												
18. Penalty for delinquency in filing return												
19. TOTAL TAX AND PENALTY												

TO FACILITATE COLLECTION OF TAX A REMITTANCE IN THE AMOUNT REPORTED MAY ACCOMPANY THIS RETURN

## CLAIM SETTLEMENT RECORD

## ADDITIONAL ASSESSMENT RECORD

AMOUNT	\$
ALLOWED	\$
REFLECTED	\$
FAIR VALUE	\$
BASIS	

Every corporation must file a return.  
Determination of liability rests with the  
Commissioner. This applies to all companies  
claiming exemption. See Arts. 17 and 31,  
Regulations 64.

PAGE	19	LIST
ADDITIONAL TAX	\$	
BY		

ALL TAXES ARE PAYABLE TO THE COLLECTOR OF THE DISTRICT IN WHICH RETURN IS FILED.

9-1361

(1)

(See Instructions on Page 4.)

[Page 1 of Form 707.]

Returns of this character are confidential and are open to inspection only under conditions specified in Section 257, Revenue Act of 1921

**EXHIBIT A.** (See Special Instructions No. 3, page 4, "Date of Balance Sheet," etc.)

**CONDENSED BALANCE SHEET AS OF** \_\_\_\_\_

REPORT AS OF JUNE 30, 1923, IF POSSIBLE, BUT IN NO CASE EARLIER THAN DECEMBER 31, 1922

**BANKS MAY ATTACH PRINTED STATEMENTS.**

DEBITS AND ASSETS.	BOOKS OF ACCOUNT.	FAIR VALUE.	DIFFERENCE. *(Explains any large amounts.)
Real estate (show separately).....	\$.....	\$.....	\$.....
Buildings (show separately).....	.....	.....	.....
Machinery (show separately).....	.....	.....	.....
Stock in subsidiaries.....	.....	.....	.....
Other securities.....	.....	.....	.....
Cash.....	.....	.....	.....
Notes receivable.....	.....	.....	.....
Accounts receivable.....	.....	.....	.....
Inventory.....	.....	.....	.....
.....	.....	.....	.....
Patents, Trademarks, etc.....	.....	.....	.....
Good will.....	.....	.....	.....
Deferred charges.....	.....	.....	.....
TOTALS.....	\$.....	\$.....	\$.....
<b>CREDITS AND LIABILITIES.</b>	<b>BOOKS OF ACCOUNT.</b>	<b>FAIR VALUE.</b>	<b>DIFFERENCE.</b>
Bonded debt..... \$.....	\$.....	\$.....	\$.....
Less in Treas.....	.....	.....	.....
Mortgages.....	.....	.....	.....
Accounts payable.....	.....	.....	.....
Notes payable.....	.....	.....	.....
Reserves—Depreciation.....	.....	.....	.....
Depletion.....	.....	.....	.....
Taxes.....	.....	.....	.....
.....	.....	.....	.....
.....	.....	.....	.....
Deferred credits.....	.....	.....	.....
Capital stock:			
Preferred..... \$.....	.....	.....	.....
Less in Treas.....	.....	.....	.....
Common.....	.....	.....	.....
Less in Treas.....	.....	.....	.....
Surplus.....	.....	.....	.....
Profit and loss.....	.....	.....	.....
TOTALS.....	\$.....	\$.....	\$.....
<b>RECAPITULATION OF EXHIBIT A.</b>		<b>This column for use of taxpayer.</b>	<b>This column for use of Department.</b>
Total of debits and assets after deducting items not actual assets.....		\$.....	\$.....
Less total of credits and liabilities after deducting capital stock, surplus, and other items not actual liabilities.....		.....	.....
Difference (value of total capital stock reflected by Exhibit A).....		\$.....	\$.....

\* Material differences will not be allowed unless satisfactorily explained.

(SEE INSTRUCTIONS ON PAGE 4.)

4-17-23

(2)

[Page 2 of Form 707.]



EXHIBIT B. (See Special Instructions No. 4, page 4.)

QUOTATIONS OR OUTSIDE SALES PRICES

(Give name of exchange or specify "Outside sales.")

SPECIAL INFORMATION

Manufacturing and trading corporations will report annual gross sales for the five years shown under Exhibit C.

MONTH.	COMMON.		FIRST PREFERRED.		FISCAL YEAR ENDED—	SALES.			
	Number of shares outstanding.	Price.	Number of shares outstanding.	Price.					
July, 1922		\$.....		\$.....					
August, 1922									
September, 1922									
October, 1922					191	\$.....			
November, 1922									
December, 1922					19				
January, 1923									
February, 1923					19				
March, 1923									
April, 1923					19				
May, 1923									
June, 1923					19				
Total									
Average	x x x x x x		x x x x x x						

RECAPITULATION OF EXHIBIT B.

This column for use of taxpayer.

This column for use of Department.

Average sale value of common stock per share, \$....., multiplied by..... number of shares outstanding.....	\$.....				\$.....				
Average sale value of first preferred stock per share, \$....., multiplied by..... number of shares outstanding.....									
Average sale value of second preferred stock per share, \$....., multiplied by..... number of shares outstanding.....									
TOTAL (value of total capital stock reflected by Exhibit B)									

Approximate number of shares traded in during the year: Common..... Preferred.....

NOTE.—Parent companies will facilitate audit by attaching supplemental Exhibit C, showing consolidated income of group.

EXHIBIT C. (See Special Instructions No. 5, page 4.)

ANNUAL INCOME (Not consolidated income of group.)

FISCAL YEAR ENDED—	NET INCOME. (Deficit in red.)	DEDUCTIONS.	ADDITIONS.	ADJUSTED INCOME.	NUMBER OF SHARES.	DIVIDENDS DECLARED.			DEPRECIATION.
						Common.	First preferred.	Second preferred.	
191	\$.....	\$.....	\$.....	\$.....		%	%	%	\$.....
19						%	%	%	
19						%	%	%	
19						%	%	%	
19						%	%	%	
Total									
Average	\$.....	x x x x x x	x x x x x x	\$.....		%	%	%	\$.....

RECAPITULATION OF EXHIBIT C.

This column for use of taxpayer.

This column for use of Department.

Average annual income as adjusted.....	\$.....				\$.....				
Capitalized at..... per cent (value of total capital stock reflected by Exhibit C)									

STATE OF.....  
COUNTY OF.....

We,....., President, and....., Treasurer, of the above-named company, whose return for special excise tax is herein set forth, being severally duly sworn, each for himself, depose and say that the items entered in the foregoing report and in any additional list or lists attached to or accompanying this return are, to his best knowledge and belief and from such information as he has been able to obtain, true and correct.

Sworn to and subscribed before me this..... day of....., 192.....

President.

[SEAL.]..... (Official capacity.)

(3)

Treasurer.  
(SEE INSTRUCTIONS ON PAGE 4.)

## SPECIAL INSTRUCTIONS

**1. REQUIRED VALUATION.**—Every domestic corporation is required to pay annually a special excise tax with respect to its capital stock or doing business, equivalent to \$1 for each \$10,000 of the market value of the fair average value of its capital stock for the preceding year ending June 30 as is in excess of \$1,000. It is mandatory whether the corporation is organized for profit or has a capital stock represented by shares.

For the purpose of this tax the fair value of the entire capital stock as a going concern, regardless of stock ownership or the ability of individual stockholders, to liquidate their holdings, is required. The sales price for any number of shares of stock less than a majority interest are not necessarily indicative of the fair value of the entire capital stock. The book value, the kind of assets, the nature of the business, good will, franchise, earnings capacity, etc., are important factors that affect the worth of enterprises and must be given due consideration in arriving at the fair value at any given date.

In order that consideration may be given the various factors affecting fair value, three exhibits are provided for furnishing information, and the taxpayer will complete each exhibit or state why the required data are not available.

**Exhibit A** provides for adjusting any overstated or understated values contained in the taxpayer's books of account, and **Exhibit C** provides for showing an adjusted income, which should be the actual operating income to be used for capitalizing on a percentage basis fixed by its officers as fairly representing conditions obtaining in the trade and in the locality. If the reconstructed book value shown by **Exhibit A**, the market value shown by **Exhibit B**, or the valuation reflected by **Exhibit C** is greater than the valuation returned by the taxpayer, a comprehensive statement showing any extraordinary conditions which are found to be in support of the valuation claimed must be submitted. In any case in which the fair value is understated the amount will be redetermined by the Commissioner and the correct tax assessed, also any penalty incurred will be asserted.

**2. EXHIBITS.**—The three exhibits, A, B, and C, are provided to indicate the information desired and the manner in which it should be furnished. So far as adaptable these forms should be completed by taxpayers. But if they find it more convenient they may attach to their return their own statements (as in the case of banks), provided substantially the same information is furnished. In any event, taxpayers should attach any additional statements that will aid in a comprehensive understanding of the taxpayer's return, so that the Commissioner of Internal Revenue may fully determine the correctness of the fair value reported in item 14 on page 1 hereof.

**3. EXHIBIT A: CORRECTED BALANCE SHEET.**—Furnish under **Exhibit A** a corrected balance sheet as of June 30, 1922. It is possible, but in no case earlier than December 31, 1922.

**"Rate of Return Sheet."**—**Exhibit A** requires data as of June 30, 1922, if possible, but in no case earlier than December 31, 1922. A corporation whose fiscal year ends between June 30 and December 31, 1922, and which finds it impossible to prepare a statement from the books as of June 30, 1922, may report in the "Rate of Return" column values as of the close of their last fiscal year, preceding December 31, 1922, and within every instance make note of the "Fair value" column and the "Rate of Return" column values as of the close of their last fiscal year, preceding June 30, 1922. This amount will agree with items 8, 9, and 10 on page 1 of the return, and no substitution of dates is permitted in either case. Where the books are closed in July or August, tentative return may be filed and completed return immediately after closing of books.

Banks should submit balance sheets as of June 30, 1922, in all cases. Published statements are acceptable unless recent action is necessary to reflect actual values.

**"Books of account."**—These columns must show the amounts as carried in the taxpayer's books of account.

**"Fair value."**—Refer to article 1 above, defining the value returned, and in the event that the columns "Books of account" contain any overstated or understated values show herein the actual values. In the case of mines, oil and gas wells, other natural deposits and timber, valuations established as the basis of depletion in computing income and profit taxes should be shown in the "Fair value" column. If any different valuation is claimed than reported in the "Fair value" column it may be stated and should be supported by reasonably conclusive evidence.

**"Differences."**—These columns will show the differences between the columns "Books of account" and "Fair value." Any material differences must be explained in such manner as to enable the Commissioner of Internal Revenue to determine if they are proper and acceptable. For this purpose the differences shown herein need not be covered by corresponding adjustments in the taxpayer's books of account.

**"Profit and loss."**—If the "Profit and loss" balance is a debit, the amount should be shown in red.

Reserve for the payment of future dividends, whether declared or not, will not be considered in arriving at the fair value. It is not necessary to cover the preceding dividend period may be considered if the dividend has been declared and not disbursed. If deducted, show date declared and date of actual payment.

**4. EXHIBIT B: QUOTATIONS ON OVERSEAS SALES PRICES.**—Furnish under **Exhibit B** the price quoted on a recognized stock exchange on the New York stock or the prices at which outside sales were made if the stock is not listed, for the period of 12 months ending June 30, 1922.

If the stock is listed, the name of the exchange from which reported quotations are taken must be shown in the space provided therefor, and the prices reported will be the mean of the highest and of the lowest bid price during each month, from which the average for the year will be obtained. If the taxpayer prefers, a schedule may be attached to this return showing the highest and lowest bid price at which stock was quoted for each day of the year and the average obtained therefrom.

If the stock is not listed and outside sales have been made at prices known or determinable by the officers making this report, such prices will be reported hereon. A statement of the number of shares involved and the conditions under which sales were made at other than exchange quotations must accompany this return. Sales to employees or directors for qualification purposes, or sales which are restricted as to resale, or sales at prices otherwise specially influenced, will not be considered representative of the fair value of the entire capital stock and should not be included.

In the column "Number of shares outstanding" should be shown the total number of shares outstanding at the close of each month. The average value per share will be determined as follows:

First. If no change occurred in the number of shares outstanding during the year, total the quotations or sales prices for the months reported and divide by the number of months in which quotations or sales prices are shown.

Second. If any change occurred in the number of shares outstanding during the year, multiply the average market price per share for the period during which the capital stock was outstanding as of June 30, 1922, has been outstanding by the number of shares outstanding as of that date.

**5. EXHIBIT C: ANNUAL INCOME.**—Furnish under **Exhibit C** the annual income and other data for the five fiscal years ended with the close of the taxpayer's fiscal year, or for the period during which the corporation has been engaged in business if for a shorter period.

**"Net income."**—In this column will be shown the income returned for the purpose of the income tax and excess profit tax.

**"Deductions" and "Additions."**—Refer to article 1 of these Special Instructions, and show in these columns such amounts as should be deducted from or added to "Net income" to arrive at the adjusted income which may be capitalized to determine the fair value of the capital stock. In comprehensive analysis of any amounts reported thereon should be attached to this return. Some of the principal items frequently requiring adjustment are:

**Deductions:**  
Income and profits taxes not deductible in computing income subject to tax.  
Interest charges not deductible in computing income subject to tax.  
Losses not fully deductible in computing income subject to tax.

**Additions:**  
Income from other corporations not included in computing income subject to tax.  
Income from securities of a State, municipality, or the United States, not included in the taxpayer's tax return.  
The difference between depletion allowed in determining net income subject to Federal income tax and the actual depletion based on cost.  
Expenses made for additions and betterments, or reserves for such purposes, charged against income, whether direct or through expenses.

**"Adjusted income."**—This column will reflect the amounts resulting from the adjustment of the amounts shown in the three preceding columns.

**"Number of shares."**—Therein should be given the total number of shares of all classes of stock outstanding at the close of each fiscal year.

**"Dividends declared."**—Therein should be reported the percentage of dividends declared on each class of stock outstanding each year. The amount represented by the percentages shown in this column must not be deducted from the columns "Net income" or "Adjusted income."

**"Depreciation."**—Herein will be reported the amount actually charged against income each year to the taxpayer's books of account for depreciation.

**Capitalizing net income.**—The officers making the return will capitalize the average annual income on a percentage basis that fairly represents, under the conditions obtaining in the trade in the locality, what representative enterprises must earn in order to maintain their stock at par. In other words, enterprises engaged in a similar business must on the average earn 12 per cent on their issued capital stock to keep the value of their stock at par, the net income should be capitalized by dividing it by 12.

## GENERAL INSTRUCTIONS

**1. NATURE OF TAX.**—The capital stock tax due July 1, 1923, is an excise tax payable in advance for the privilege of doing business from July 1, 1922, to June 30, 1923.

**2. DATE OF FILING RETURNS.**—During July of each year.

**3. TENTATIVE RETURN.**—Filing of a tentative return will avoid penalty for delinquent filing, but does not substitute withholding of the tax. Complete return as far as possible and submit an approximate estimate as a basis in order that an initial assessment may be made. (See Art. 21, Reg. 65.)

**4. EXAMINATION OF RECORDS AND WITNESSES.**—For the purpose of ascertaining the correctness of any return or of making a return where none has been made or of preparing a new return where the one submitted is false or fraudulent the Commissioner has authority to designate a revenue agent or inspector to examine witnesses and books, records, papers, or other documents.

**5. EXTENSION OF TIME.**—In the event of sickness or absence of the officer charged with making the return, it is impossible to prepare and file a return on or before July 31, the collector, upon application in writing, may allow an extension of not exceeding 30 days for making and filing the return. If extension is granted, the letter of the collector must be attached to the return. No extension of time will be granted to the collector his authority by grant an extension greater than 30 days from July 31.

**6. SIGNATURES AND VERIFICATION.**—Returns must be signed and verified by two officers of the corporation, one is by the president, the president, or other principal officer, and by the treasurer or other financial officer, and must be sworn to before an officer authorized to administer oaths, and the seal of the attesting officer, if then required to have a seal, must be impressed on the return. The name of the corporation and the names of the officers signing the return should be plainly written or printed on the return. If, however, the tax is covered by this return filed and not paid, the return may be signed or acknowledged before two witnesses instead of under oath.

**7. TAX.**—From the total fair average value of the capital stock the sum of \$5,000 is deducted and the tax is at the rate of \$1 for each full \$1,000 of any balance. (See lines 14 to 17 on page 1.)

**8. PENALTIES.**—In case of any failure to make and file a return or list within the time prescribed by law, or prescribed by the Commissioner of Internal Revenue or the collector in pursuance of law, the Commissioner of Internal Revenue shall add to the tax 25 per centum of the amount due, except that where a return is filed after such time and it is shown that the failure to file it was due to a reasonable cause and not to willful neglect, no such addition shall be made to the tax. In case of a false or fraudulent return or list it willfully made, the Commissioner of Internal Revenue shall add to the tax 50 per centum of the amount due. If the tax is payable to the collector at any time after July 1, 1923, but penalties for nonpayment due to willful neglect and on days after notice and demand has been served by the collector on the taxpayer. (See sections 1094, 1095, and 1096, Revenue Act of 1921, and section 2161, R. S.)

**9. REGULATIONS.**—For further information regarding the tax see Regulations 64.

49-12653

INTERNATIONAL PAPER COMPANY



Form 708  
U. S. INTERNAL REVENUE

# 1924 RETURN

## CAPITAL STOCK TAX

### FOR FOREIGN CORPORATIONS

(Rev. 1000, Revenue Act of 1921)

(To be stamped by Collector, showing District and date received.)

(Collection District)  
Assessment List, Form No. 23 A.  
(Month) (Year)  
(Page) (Line)  
Audited by

File with Collector of Internal Revenue for your district on or before July 31, 1923, to avoid penalty.

1. Name.....  
(Print name of corporation, joint-stock company, or association.) (Show former name, if changed.)
2. Address.....  
(The address in the United States must be that of the principal place of business of the corporation.)
3. Home Office located at.....  
(Give street and number, city or town, and country.)
4. Nature of business in detail..... (Return for previous year filed in ..... District.)
5. Affiliated company or companies.....

## TAX PAYABLE ANNUALLY IN ADVANCE.

Return for taxable period July 1, 1923, to June 30, 1924, based on the average amount of capital employed in the transaction of its business in the United States for preceding year.

## COMPUTATION OF TAX.

Foreign Corporations. (See General Instructions 3.)

6. Average capital employed in the transaction of business in the United States and elsewhere for the year ended June 30, 1923:
- |   |         |
|---|---------|
| Common stock outstanding.....                 | \$..... |
| Preferred stock outstanding.....              | \$..... |
| Surplus.....                                  | \$..... |
| Undivided profits.....                        | \$..... |
| TOTAL.....                                    | \$..... |
| Total net income.....                         | \$..... |
| Net income from sources in United States..... | \$..... |
7. Average capital employed in the transaction of business in the United States for the year ended June 30, 1923:
- |  |         |
|--|---------|
| Real estate.....   | \$..... |
| Mortgage loans.....  | \$..... |
| Bonds held in the United States.....   | \$..... |
| Stocks of subsidiary companies located in the United States.....                                     | \$..... |
| Other securities held in the U. S.....   | \$..... |
| Cash.....  | \$..... |
| Other assets.....  | \$..... |
| Vessels used in transportation of passengers and merchandise between domestic and foreign ports..... | \$..... |
| TOTAL.....   | \$..... |
| Deduct that portion of actual liabilities which total of Item 7 bears to the total gross assets..... | \$..... |
| Taxable amount.....  | \$..... |
8. Tax at the rate of \$1 for each full \$1,000.....
9. Penalty for delinquency in filing return.....
10. Total tax and penalty..... \$.....

\* Transportation companies owning or operating vessels plying between the United States and other countries involving the use of vessels not physically maintained in the United States will complete Exhibit on page 2 and determine value of vessels in accordance with instructions thereunder.

\* Each corporation will attach to the return a copy of its published financial statements as of the close of its fiscal year next preceding June 30, 1923, in support of any deduction claimed. (See General Instructions No. 11-B, page 3.)

## TO FACILITATE COLLECTION OF TAX A REMITTANCE IN THE AMOUNT REPORTED MAY ACCOMPANY THIS RETURN

## CLAIM SETTLEMENT RECORD

AMOUNT.....	\$.....
ALLOWED.....	\$.....
REJECTED.....	\$.....
FAIR VALUE.....	\$.....
BASE.....	

Every corporation engaged in business in the United States shall make returns on this form irrespective of the amount of capital employed in this country in the transaction of its business, unless such corporation was not engaged in business in the United States during the preceding fiscal year, July 1, 1922, to June 30, 1923, or is specifically exempt under the provisions of Section 231, Title II, of the Revenue Act of 1921.

## ADDITIONAL ASSESSMENT RECORD

.....	19	LIST
PAGE.....	LINE.....	
ADDITIONAL TAX, \$.....		
BY.....		

ALL TAXES ARE PAYABLE TO THE COLLECTOR OF THE DISTRICT IN WHICH RETURN IS FILED.

9-15980

(1)

(SEE INSTRUCTIONS ON PAGE 3.)

[Page 1 of Form 708.]

## EXHIBIT. FOR USE OF OCEAN TRANSPORTATION COMPANIES

(See Treasury Decision No. 5387.)

Information required under this Exhibit is desired for use in the determination of that portion of the capital employed in the transaction of business in the United States, attributable to the floating equipment, not physically maintained within the United States, but used in transporting passengers or merchandise between American and foreign ports.

Where a corporation has employed more than one ship in the above-mentioned business during the year ended June 30, 1923, a separate supplemental schedule will be required for each vessel so employed, as a consolidated statement for all vessels will not serve the purpose of the Bureau:

1. Name of vessel .....
2. Nature and use to which put .....
3. Date constructed or acquired .....  
(Month) (Year)
4. Cost ..... \$
5. Value to company as a going concern on June 30, 1923 ..... \$
6. Total number of days this particular ship was in service during the year ended June 30, 1923 .....
7. Total number of days this particular ship was in service within the territorial limits of the United States during the year ended June 30, 1923 .....
8. The valuation which will be entered under "Vessels" on page 1, item 7, is found by taking that proportion of the value of the vessel as stated in item 5, which the total number of days the vessel was employed within territorial waters of the United States (7) bears to the total number of days the vessel was in service during the year (6) ..... \$

If more than one vessel was so employed, the amount carried to page 1 of the Return will be the aggregate amount taken from supplemental schedules for each vessel so employed

STATE OF ..... }  
COUNTY OF ..... } SS:

I, ..... of the United States branch of the above-named foreign company, whose return for special excise tax is herein set forth, being duly sworn, depose and say that the items entered in the foregoing report and in any additional list or lists attached to or accompanying this return are, to my best knowledge and belief, and from such information as I have been able to obtain, true and correct in each and every particular

Sworn to and subscribed before me this ..... day of ..... 192

[ SEAL OF OFFICER ]  
[ TAKING AFFIDAVIT ]

(Agent, attorney, or other official capacity.)

(Official capacity.)

(Name of officer or agent to whom correspondence should be addressed.)



Returns of this character are confidential and are open to inspection only under conditions specified in Section 257, Revenue Act of 1921.

### GENERAL INSTRUCTIONS.

1. **Nature of tax.**—The capital stock tax due July 1, 1923, is an excise tax, payable in advance, for the privilege of doing business from July 1, 1923, to June 30, 1924. The amount of the tax is computed upon the average amount of capital employed by a foreign corporation in the transaction of its business in the United States for the preceding fiscal year.

2. **Time for filing returns.**—During the month of July, and annually thereafter.

3. **Foreign corporations required to make returns.**—Every corporation engaged in business in the United States shall make return on this form irrespective of the amount of capital employed in this country in the transaction of its business, unless such corporation was not engaged in business in the United States during the preceding fiscal year, July 1, 1922, to June 30, 1923, or is specifically exempt under the provisions of Section 231, Title II, of the Revenue Act of 1921.

In supplying data under item 7, details relating to real estate, mortgage loans, etc., may be omitted, but a supplementary statement should be attached explaining how the average amount of capital employed in the transaction of its business in the United States has been computed.

4. **Examination of records and witnesses.**—For the purpose of ascertaining the correctness of any return or of making a return where none has been made or of preparing a new return where the one submitted is false or fraudulent the Commissioner has authority to designate a revenue agent or inspector to examine witnesses and books, records, papers, or other memoranda.

5. **Extension of time.**—If on account of sickness or absence of the officer charged with making the return it is impossible to prepare and file a return on or before July 31, the collector, upon application in writing, may allow an extension of not exceeding 30 days for making and filing the return. If extension is granted, the letter of the collector must be attached to the return. Neither the Commissioner nor the collector has authority to grant an extension greater than 30 days from July 31.

6. **Tentative return.**—Filing of a tentative return will avoid penalty for delinquent filing, but does not authorize withholding of the tax. Complete return as far as possible and submit an approximate estimate as a basis in order that an initial assessment may be made. (See Art. 21, Reg. 64.)

7. **Signatures and verification.**—Returns must be signed and verified by the agent or attorney, or other principal officer, in charge of the United States branch of the foreign corporation, and must be sworn to before an officer authorized to administer oaths, and the seal of the attesting officer, if he is required to have a seal, must be impressed on the return in the space provided for that purpose. If, however, the tax covered by this return does not exceed \$10, the return may be signed or acknowledged before two witnesses instead of under oath.

8. **Corporations liable to tax.**—Every corporation created or organized outside the United States and engaged in business in the United States, shall be liable to the capital stock tax except such companies and associations as are specifically exempt under Section 231 of Title II of the Revenue Act of 1921.

9. **New corporations.**—This tax shall not be imposed upon any corporation not engaged in business in the United States for any portion of the fiscal year July 1, 1922, to June 30, 1923.

10. **Computation of tax.**—The method of computation is prescribed on the face of this form.

11. **Tax.**—The tax is at the rate of \$1 for each full \$1,000 of the average amount of capital employed in the transaction of business in the United States.

(a) **Transportation companies** owning or operating vessels plying between the United States and other countries, either as their principal business or supplemental to their principal business, will submit the data indicated under Exhibit on page 2 in order that that portion of capital represented by the floating equipment may be included as part of the taxable amount.

(b) **Deduction of liabilities.**—Capital employed in the transaction of its business in the United States means that portion of the total capital, surplus, and undivided profits of the foreign corporation utilized for the purpose of doing business in the United States. Therefore, a foreign corporation may deduct that portion of its actual liabilities which the gross capital employed in the United States bears to the total gross assets of the corporation, provided a copy of its financial statement is attached to the return in support of the deduction claimed. Amounts claimed on this account will be disallowed unless supported.

12. **Penalties.**—In case of any failure to make and file a return or list within the time prescribed by law, or prescribed by the Commissioner of Internal Revenue or the collector in pursuance of law, the Commissioner of Internal Revenue shall add to the tax 25 per centum of its amount, except that when a return is filed after such time and it is shown that the failure to file it was due to a reasonable cause and not to willful neglect, no such addition shall be made to the tax. In case a false or fraudulent return or list is willfully made, the Commissioner of Internal Revenue shall add to the tax 50 per centum of its amount. The tax is payable to the collector any time after July 1, 1923, but penalties for nonpayment do not attach until ten days after notice and demand has been served by the collector upon the taxpayer. (See Sections 1004, 1302, and 1311, Revenue Act of 1921, and Section 3184, R. S.)

13. **Regulations.**—For further information regarding the tax see Reg. No. 64.

(3)

9-12080

OFFICE OF THE REVENUE OFFICER

[Page 1 of Form 708.]

Page 4 of Form 708 is blank.

The next page is page 609 opposite.



## CAPITAL STOCK TAX REGULATIONS.

## REGULATIONS 64

(1922 EDITION)

(Promulgated June 15, 1922. Released for publication June 22, 1922.)

[Also designated as T. D. 3361.]

RELATING TO THE

## CAPITAL STOCK TAX

UNDER THE

## REVENUE ACT OF 1921

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**3005 Article 1. The law.**—The main provisions of existing law with respect to this tax are embodied in section 1000 of the Revenue Act of 1921, referred to hereinafter as the act.

## EFFECTIVE DATE.

**3006 Art. 2. Due date of tax.**—The act was approved November 23, 1921, but the tax is effective from July 1, 1922, except upon the incorporation of an individual or partnership business (see art. 32). This is a special tax and like all special taxes is due and payable annually in advance from July 1 of each year. No portion of the tax so paid is refundable to a corporation which ceases to do business during the year.

## CORPORATIONS DEFINED AND DISTINGUISHED.

[¶8086 to ¶8089.]

**3007 Art. 3. Corporations.**—The term "corporation" includes associations, and joint-stock companies, whether created by statute or by contract, but no partnerships, properly so called. It is immaterial whether the companies were organized for profit or have a capital stock represented by shares.

**3008 Art. 4. Associations and joint-stock companies.**—Associations and joint-stock companies include organizations, by whatever name known, which act or do business in an organized capacity, whether created



**CAPITAL STOCK TAX REGULATIONS.**

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under and pursuant to State laws, agreements, declarations of trust, or otherwise, the net income of which, if any, is distributable among the members or shareholders on the basis of the capital stock held by each, or, where there is no capital stock, on the basis of the proportionate share of capital which each has or has invested in the business or property of the organization. But see articles 5, 6, 7, 8. An organization, the membership interests in which are transferable without the consent of all of the members, however the transfer may be otherwise restricted, and the business of which is conducted by trustees or directors and officers without the active participation of all the members as such, is an association.

**3009 Art. 5. Limited partnerships as corporations.**—Partnerships with limited liability or partnership associations authorized by the statutes of Pennsylvania and a few other States are only nominally partnerships. Such so-called limited partnerships, offering opportunity for limiting the liability of all the members, providing for the transferability of partnership shares, and capable of holding real estate and bringing suit in the common name, are more truly corporations than partnerships, and are taxable as corporations. In all doubtful cases, limited partnerships will be treated as corporations unless they submit satisfactory proof that they are not in effect so organized. Michigan partnership associations are corporations. The liability of Virginia limited partnerships is determined in each case from a consideration of the certificate of partnership and all pertinent facts relative thereto.

**3010 Art. 6. Limited partnerships as partnerships.**—So-called limited partnerships of the type authorized by the statutes of New York and most of the States are partnerships and not corporations within the meaning of the statute. Such limited partnerships which can not limit the liability of the general partners, although the special partners enjoy limited liability so long as they observe the statutory conditions, which are dissolved by the death or transfer of the interest of a general partner, and which can not hold real estate or sue in the partnership name, are so like common law partnerships that they can not be differentiated therefrom for tax purposes. Michigan and Illinois limited partnerships are partnerships. California special partnerships are partnerships.

**3011 Art. 7. Partnership banks.**—A partnership bank, conducted like a corporation and so organized that the interests of its members may be transferred without the consent of the other members, is a joint-stock company or association within the meaning of the statute. A partnership bank, the interests of whose members can not be so transferred, is a partnership.

**3012 Art. 8. Massachusetts trusts.**—The test of liability in all cases involving trusts of the Massachusetts type is whether the *cestuis que trustent* have by the terms of the trust agreement a voice in the management or control of the trust. Where the trustees are in complete control of the business, the beneficiaries having no control except the right of filling vacancies among the trustees or of consenting to a modification of the terms of the trust or of dissolving the trust, no association exists. If, however, the *cestuis que trustent* have a voice in the control or management of the business of the trust, whether through the right to elect trustees periodically or to remove the trustees or to restrict the trustees as to the management of the trust or

## CAPITAL STOCK TAX REGULATIONS.

otherwise, the trust is an association within the meaning of the statute. Where the trustees hold in their own right a sufficient number of the certificates of beneficial interest to constitute control as between the beneficiaries, the trust will be held to be an association regardless of the powers conferred upon the trustee by the instrument creating the trust.

**3013 Art. 9. Domestic corporations.**—A domestic corporation is a corporation created or organized in the United States, which includes the States, Territories of Alaska and Hawaii, and the District of Columbia.

**3014 Art. 10. Foreign corporations.**—A foreign corporation is a corporation created or organized outside the United States as defined in Article 9.

## TAX ON DOMESTIC CORPORATIONS.

**3015 Art. 11. Basis of the tax: "Carrying on or doing business."**—The basis of the tax in the case of a domestic corporation is "carrying on or doing business" in the capacity of a corporation or association. The words "carrying on or doing business" must be given their ordinary and natural signification. "Business" is a very comprehensive term and embraces whatever occupies the time, attention, or labor of men for the purpose of livelihood or profit. In other words, business necessarily involves the idea of gain.

**3016** The true basis of distinction is, in the first instance, between—

- (a) A corporation organized for the purpose of doing business as above defined, and
  - (b) A corporation organized for the sole purpose of owning and holding property and distributing its avails;
- and, in the second instance, between—

- (c) A corporation of class (a) which is continuing the body and substance of the business for which it was organized or is still active and maintaining its organization for the purpose of continued efforts in the pursuit of profit or gain, and
- (d) A corporation which, although included in class (a), has substantially retired from the business for which it was organized and has reduced its activities to the mere ownership and holding of property, distributing its avails, and doing only the acts necessary to the maintenance of its corporate existence and the private management of its purely internal affairs.

**3017** The distinction in each case must depend upon the peculiar facts in the case. Corporations of class (a) will be presumed to be subject to the tax unless they submit proof, satisfactory to the Commissioner, that they are not actually carrying on or doing business. If a corporation claim exemption on the ground that it belongs to class (b), it will be required to file an excerpt from its charter setting forth its corporate powers together with a full and comprehensive statement showing the nature of the activities in which it is and has been actually engaged. If it claim exemption on the ground that it belongs to class (d), it will be required to furnish a copy of any amendment of its charter, or other evidence, satisfactory to the Commissioner, showing that it has reduced its activities to the mere ownership of property, receipt of its avails, and the doing of only what is necessary to the maintenance of its corporate existence.



**CAPITAL STOCK TAX REGULATIONS.**

**3018** A corporation that has "substantially retired from business" is one that has changed its status, as, for instance, by divesting itself of all control over and management of the property formerly employed by it in the doing of business, and has reduced its activities accordingly.

**3019** The leasing of all the property of a corporation whereby it divests itself of control and management thereof, or the sale of all the property of a corporation and the reduction of its activities to the collection of the proceeds of the sale on an installment plan, are instances of a corporation substantially retiring from business.

**3020** Art. 12. "Carrying on or doing business" illustrated.—Corporations organized for the purpose of and actually engaged in such activities as buying, selling, or dealing in mineral or timber land or other real estate; leasing property, collecting rents, managing office buildings, making investments of profits; leasing lands and collecting royalties, managing wharves, dividing profits; and in some cases investing the surplus, are engaged in "carrying on or doing business" within the meaning of the statute.

**3021** A corporation may complete its organization and sell its capital stock for cash without incurring liability, but other activities, such as entering into contracts for the purchase of property or construction of a plant are corporate business acts, and constitute doing business. In other words, it is not necessary that a company be actually engaged in the manufacture of its intended product or that it be actually creating profit or gain to incur liability. The making of contracts, buying of materials or machinery, constructing buildings, employing and discharging of individuals are necessary business acts leading to the more profitable end of manufacturing certain products.

**3022** The letting of a contract and construction of a hotel preparatory to engaging in the hotel business is sufficient to incur liability.

**3023** A corporation organized for the purpose of, and actually engaged in, buying mineral or timber land or other real estate and holding it with a view to future sale at an advance is carrying on or doing business.

**3024** A corporation organized for the purpose of owning and leasing real estate which has leased all of the property under its control is still engaged in doing business unless, under the terms of its lease, its activities have been reduced to the mere receipt and distribution of the avails of the leases at the actual cost of so doing. If it is still maintaining its organization for the purpose of continued effort in the pursuit of profit and gain it is doing business.

**3025** A corporation owning or managing real estate which leases all of its property, but under the terms of the lease is required to maintain or keep the property in repair, is doing business.

**3026** No particular amount of business is required in order to bring a company within the terms of the act.

**3027** A corporation engaged in mining or in developing and speculating in mineral lands is doing business.

**3028** A corporation engaged in buying and selling securities or other property is doing business, even though for a period it makes no purchases or sales because of unfavorable market conditions.

**3029** A corporation formed to take over miscellaneous stocks, bonds, or other property (as of an estate), to negotiate sales of various items from time to time as opportunity and judgment dictate, and to distribute

**CAPITAL STOCK TAX REGULATIONS.**

the profits from time to time as liquidation is effected, is, while so engaged, carrying on or doing business.

**3030** A parent corporation which finances or manages the operations of its subsidiaries is doing business.

**3031** A so-called holding company which, under its charter, is authorized to and does, in addition to receiving and distributing the avails of the property or securities, held by it, finance the operations of its subsidiaries, is engaged in doing business.

**3032** A corporation organized for the purpose of taking over and holding securities, timber land, coal lands, or other real estate, is held to be doing business, if it makes investments or reinvestments of its surplus income or funds in excess of an amount necessary to maintain its original investments.

**3033** **Art. 13. Not "doing business."**—Holding companies as distinguished from parent corporations, and corporations all of whose property and business is operated by, or is in the hands of, a receiver or the Alien Property Custodian, are not doing business.

**3034** A holding company is defined as one whose corporate powers are limited to the mere owning and holding of property and distribution of its avails, or one which, although incorporated for the purpose of doing business as defined in article 11, has substantially retired from the business for which it was organized and has reduced its activities to the mere ownership and holding of property, distributing its avails, and doing only such acts as are necessary to the maintenance of its corporate existence and the private management of its purely internal affairs.

**3035** A holding company, as above defined, will not be considered to be doing business by reason of the reinvestment of its surplus income or funds to the extent only of maintaining its original investments.

**3036** **Art. 14. Computation of tax.**—The tax is imposed at the rate of \$1 for each full \$1,000 of the fair average value of the capital stock of the corporation in excess of the prescribed deduction of \$5,000.

**3037** The tax being payable in advance is prospective and is measured by the fair average value for the year preceding the taxable year, not the fair value of the average capital stock. If a corporation begins business within the preceding year or increases or decreases its capital within the preceding year, thereby materially changing the fair value of the capital stock, the tax is measured by the fair value of the capital stock outstanding at the date of incidence of the tax (June 30). Therefore, while Form 707 permits, as a matter of convenience to the taxpayer, the using of a balance sheet as of a date prior to June 30, but not prior to the preceding December 31, if there is a material change in the condition and affairs of the company affecting the fair value of the capital stock subsequent to the closing of the books and prior to the date of the incidence of the tax (June 30), the financial condition should be reported under Exhibit A as of June 30, giving effect to such material changes. Under Exhibit B, the market value will be determined by multiplying the average market price per share for the period during which the capital stock as of June 30 has been outstanding by the number of shares outstanding as of that date.

**3038** No deduction is allowed corporations organized in the United States for capital invested outside of the United States. If the corporation is doing business it is taxed on its entire capital stock even though most of it may not be employed in the business.



**CAPITAL STOCK TAX REGULATIONS.**

**3039 Art. 15. Fair average value of capital stock.**—The fair average value of the capital stock for the purpose of determining the amount of the capital stock tax must not be confused with the market value of the shares of stock where it may be necessary to determine such value under other provisions of the revenue laws. The fair average value of the capital stock, the statutory basis of the tax, is not necessarily the book value or the value based on prices realized in current sales of shares of stock or the value determined by capitalization of earnings.

**3040** Form 707 [page 603] provides Exhibit A for the book or fair value of the assets, Exhibit B for the market value of the shares, and Exhibit C for the value of the capital stock based on the capitalized earnings. All information called for must be given in every case where it is procurable. The fair average value of the capital stock of a corporation and the tax payable thereon shall be determined from a consideration of the data contained in the return as well as all elements and factors affecting values, which should be harmonized so far as possible in the ultimate fair value found. Fair value is required irrespective of the exhibit used or the method employed in its determination.

**3041** Exhibit A.—The character of the assets is probably the most important factor in determining the reliability of the value reflected by this exhibit as being indicative of the fair value of the capital stock. If the market value of the assets be established the fair value of the capital stock is held to be not materially less than the fair market value of the net assets. Attempts to average the assets as a means of estimating the fair average value of the capital stock are not permitted.

**3042** Exhibit B.—The market is regarded as a factor, but only of importance when the underlying factors upon which the market has been established are sound in all essential particulars.

**3043** Exhibit C.—The weight attaching to this exhibit is largely dependent upon the nature of the business and character of the assets.

**3044** In capitalizing the net earnings of the corporation, which should reflect the true earning capacity, the officers should use a rate fairly representing the conditions obtaining in the trade and in the locality, with due regard to other important factors, including the worth of money. But such fair value must not be greatly at variance with the reconstructed book value shown by Exhibit A, unless the corporation is materially affected by extraordinary conditions which support a lower valuation. In any such case a full explanation must accompany the return. The commissioner will estimate the fair value of the capital stock in cases regarded as involving any understatement or undervaluation.

**3045** The fair value of the capital stock, as provided under section 1000 (a) (1) of the Revenue Act of 1921, and invested capital under the excess-profits tax provisions of the Revenue Act of 1921 are not necessarily the same.

**3046** For the purpose of capital-stock tax the fair value of the capital stock is estimated, and is predicated on present values, including actual appreciation of property, whether realized or unrealized, and such intangible assets as good will, trade-marks, and patents to the extent reflected by the earning power, whereas, for the purpose of excess-profits tax, the invested capital is based upon the actual investment of the stockholders in the corporation, irrespective of the present value of its assets. In the case of the capital-stock tax the fair value looks to the present net value of the

## CAPITAL STOCK TAX REGULATIONS.

assets, irrespective of the amount of the investment of the stockholders. (See art. 863, Reg. 62 [¶1234].)

**3047 Art. 16. Surplus and undivided profits.**—The surplus and undivided profits of a corporation must be included in estimating the fair average value of its capital stock. If the fair average value be determined from the book value, the surplus and undivided profits are included in the assets; if from sales, they are necessarily a factor in determining the market price; and, if from net income, they are reflected to a greater or less extent in the earnings.

## RETURNS.

[¶8000 and ¶8001.]

**3048 Art. 17. Return by domestic corporation.**—Every domestic corporation must make a return on Form 707 [page 603] even though the law may indicate that it is exempt from the tax. The question of exemption is one for determination by the commissioner. Also see articles 31 and 20.

**3049 Art. 18. Return by affiliated corporation.**—Although section 240 [¶1074] of the Revenue Act of 1921 requires a consolidated return for affiliated corporations for the purpose of income tax, *for the purpose of capital stock tax each corporation must render a separate return in complete form.* So-called subsidiary corporations, all or a part of the stock of which is owned by another corporation, must render separate returns, the same as every other corporation. No deductions from the assets are permitted on account of intercompany balances, and the shareholdings must be reported in the "Fair value" column at their actual worth at the time of making the return. No deduction is allowed in the return of one corporation for the tax paid by another.

**3050** If the fair value is determined by any method other than herein provided, the following requirements must be complied with: (a) The parent company must submit with its return a list of all subsidiaries and the districts in which the returns were filed; (b) the return of the subsidiary company must show the name of the parent company and the district in which the return was filed; (c) the method of determining the fair value, if other than by Exhibits A, B, and C, must be fully explained; (d) a copy of any agreement existing between parent company and subsidiary must be furnished, or a statement made that none exists; and (e) a combined balance sheet and a combined net income statement must be submitted for consideration in connection with any estimate of fair value made on behalf of the reporting corporation.

**3051 Art. 19. Verification of return.**—The return and any separate statement submitted therewith must be verified in the form printed on page 3 of the return. In the absence of the president or treasurer, or both, other responsible officers may execute the jurat to avoid delinquency. However, if the amount of the tax covered thereby is not in excess of \$10, the return may be signed or acknowledged before two witnesses instead of under oath. (Sec. 1303 of the Act [¶8009].)

**3052 Art. 20. Time for making return.**—It shall be the duty of every corporation on or before the 31st day of July in each year to make



**CAPITAL STOCK TAX REGULATIONS.**

a return to the collector of the district in which its principal place of business is located. If any corporation fails to make and file a return within the time prescribed by law or by regulation made under authority of law, or makes, willfully or otherwise, a false or fraudulent return, the collector or deputy collector shall make the return from his own knowledge and from such information as he can obtain through testimony or otherwise. In any such case the commissioner may, from his own knowledge and from such information as he can obtain through testimony, or otherwise, make a return or amend any return made by a collector or deputy collector. Any return so made and subscribed by the commissioner, or by a collector or deputy collector and approved by the commissioner, shall be prima facie good and sufficient for all legal purposes. If on account of sickness or absence of the officer of the corporation charged with making the return, it is impossible to prepare and file a return on or before the 31st day of July (the due date), the collector, upon application in writing, may allow an extension of time not exceeding 30 days from July 31, in which to file the return. *If extension is granted, the letter of the collector should be attached to the return.* (See Sec. 3176, R. S. [§8071].)

**3053** On no account is the Commissioner of Internal Revenue or the collector authorized to grant an extension of time in which to file capital stock tax returns in excess of 30 days from July 31, the due date. If for reasons, other than absence or sickness, beyond the control of the officers making the return, it becomes impossible to file a completed return within the time prescribed by law, a tentative return may be filed.

**3054 Art. 21. Tentative return.**—The filing of a tentative return within the prescribed period will avoid the penalty for delinquent filing, but will not authorize the withholding of the tax. The regulations do not permit the filing of a tentative return to stay indefinitely the filing of a completed return and the collection of the tax due. Therefore if a tentative return is filed it should be clearly marked "Tentative Return" and should be prepared in as complete a manner as possible, including, among other information, a basis of the computation of the tax—that is, an estimate by the officers of the corporation of the approximate fair value of the capital stock in order that an initial assessment may be made. When the completed return is filed, it should be clearly marked "Completed return," showing that a tentative return was filed. Such action will prevent duplicate assessments and ordinary penalties. In every case a statement should be attached to the tentative return, indicating the approximate date the completed return may be expected. Upon receipt of the completed return any adjustment necessary in the assessment of the correct tax due will be made.

**TAX ON FOREIGN CORPORATIONS.**

**3055 Art. 22. Basis of the tax.**—The basis of the tax in the case of a foreign corporation is "carrying on or doing business in the United States." Foreign insurance companies are not liable to capital stock tax. (See art. 29.)

**3056** A foreign corporation is carrying on or doing business in the United States if it maintains an agent or an office or warehouse in the United States or in any other way enters the United States for the purpose of its business. The purchase of supplies in the United States in the furtherance

**CAPITAL STOCK TAX REGULATIONS.**

of continued efforts in the pursuit of profit or gain is carrying on or doing business in the United States.

**3057 Art. 23. Capital employed in the United States.**—The “capital employed in the transaction of its business in the United States” means the portion of the total capital, surplus, and undivided profits, of the foreign corporation, utilized for the purpose of doing business in the United States. A foreign corporation may have income from sources within the United States for the purpose of the income tax, and yet not have capital employed in the transaction of business here for the purpose of the capital-stock tax. Compare articles 92–94 and 316–329 of Regulations 62 [see Income Tax Service, beginning on page 93]. A foreign corporation not actually doing business in the United States is not subject to tax, and, accordingly, the investment of a part of its funds in United States stocks and securities will not constitute capital employed in its business in the United States. For the definition of “doing business” see article 11. If a corporation does business in this country, then, although the mere investment of funds in United States securities is not such a taxable employment of capital, such investment will constitute capital employed in the transaction of business in the United States if made in a subsidiary corporation which the foreign corporation uses as an instrumentality for the conduct of its own business in the United States. Thus the investment of the funds of a foreign corporation in the purchase of facilities, although apparently independent, for the purpose of its business here, or the purchase of stock and securities of a subsidiary corporation for the same purpose, will constitute the employment of capital in the transaction or business in the United States. A foreign corporation may not escape taxation by organizing or purchasing the stock of another corporation to own the facilities which the foreign corporation needs in its business. See article 352, Regulations 62. [See Income Tax Service, beginning on page 93].

**3058 Art. 24. Capital employed in the United States illustrated.**—A foreign corporation may employ capital in the transaction of its business in the United States in various ways. For example, the investment of funds in property in the United States used in its business, in stocks and securities of subsidiary corporations as explained in article 23, in bills and accounts receivable representing business done in the United States, in merchandise kept here for sale, in materials manufactured here, and in deposits in United States banks maintained for use in business here. Generally speaking, approximately such proportion of the entire capital of a foreign corporation will presumably be employed in the transaction of its business in the United States as the gross amount of its business in the United States bears to its total gross business, but this will not always be conclusive, since a corporation may conceivably transact a greater or less volume of business in one country than in another on the same amount of capital.

**3059 Art. 25. Return by foreign corporation.**—Every foreign corporation carrying on or doing business in the United States shall make return on Form 708 [page 607], irrespective of the amount of capital employed in this country in the transaction of its business. The capital actually employed in the transaction of the business of a foreign corporation in the United States and the tax payable thereon shall be calculated in accordance with the instructions on the form.



## CAPITAL STOCK TAX REGULATIONS.

**3060 Art. 26. Computation of tax.**—The tax is at the rate of \$1 for each full \$1,000 of the capital of a foreign corporation actually employed in the transaction of its business in the United States, and is in all cases to be computed on the basis of the average amount of capital so employed during the preceding year ending June 30. The measure of the tax is accordingly different from that of domestic corporations which pay a tax measured by the fair average value of their capital stock. No deduction from the total fair average amount of capital so employed is allowed in computing the tax.

**3061 Art. 27. Measure of tax.**—The measure of the tax is the average amount of capital employed in the transaction of business in the United States during the preceding fiscal year. It will usually be sufficient to determine the amount of capital so employed at the beginning of each year and the amount so employed at the end of such year, and to divide the sum of such amounts by two. Where, however, there have been material changes in the amount of capital, the average amount should be determined with due regard to the times at which such changes occurred. A foreign corporation may, if it so desire, compute the average amount of capital employed on a monthly basis.

## EXEMPTION FROM TAX.

**3062 Art. 28. Corporation not in business during preceding year.**—The tax being payable in advance does not apply to any corporation which was not engaged in business during any part of the fiscal year preceding the year for which the tax is due, but if it was in business even one day of the preceding year and one day of the taxable year it is subject to the tax. There is no relation between the amount of the tax payable and the length of time the corporation was in business. A corporation engaged in business during a part of the preceding year, but not engaged in business at the beginning of the taxable year, is not required to make any return if it is dissolved or in process of dissolution, but if it is only temporarily inactive and subsequently during the year re-engages in business it should file a return in the month in which it recommences business and pay the tax due from the first of such month to the end of the taxable year. A corporation organized and beginning corporate activities on or after July 1 is not subject to tax for the remainder of the taxable period in which the company was organized, unless, as of *July 1*, it takes over the business of an organization which was subject to capital stock tax, in which event the new corporation is required to file a return and pay the tax. Also see article 32 relative to election to be taxed as a corporation. In the case of foreign corporations "engaged in business" means the transaction of any business within the United States.

**3063 Art. 29. Organizations and insurance companies exempt.**—The tax does not apply to insurance companies (stock, mutual, domestic, or foreign) nor to corporations the fair value of whose capital stock for the preceding year does not exceed \$5,000 nor to any of the following classes of corporations specified in section 231 of the act, viz.:

(1) Labor, agricultural, or horticultural organizations. [See Art. 512, Reg. 62, Income Tax Service, page 93.]

**3064** (2) Mutual savings banks not having a capital stock represented by shares. [See Art. 513, Reg. 62, Income Tax Service, page 93.]

## CAPITAL STOCK TAX REGULATIONS.

- 3065** (3) Fraternal beneficiary societies, orders, or associations, (a) operating under the lodge system or for the exclusive benefit of the members of a fraternity itself operating under the lodge system; and (b) providing for the payment of life, sick, accident, or other benefits to the members of such society, order, or association or their dependents. [See Art. 514, Reg. 62, Income Tax Service, page 93.]
- 3066** (4) Domestic building and loan associations substantially all the business of which is confined to making loans to members; and co-operative banks without capital stock organized and operated for mutual purposes and without profit. [See Art. 515, Reg. 62, Income Tax Service, page 93.]
- 3067** (5) Cemetery companies owned and operated exclusively for the benefit of their members or which are not operated for profit; and any corporation chartered solely for burial purposes as a cemetery corporation and not permitted by its charter to engage in any business not necessarily incident to that purpose, no part of the net earnings of which inures to the benefit of any private stockholder or individual. [See Art. 516, Reg. 62, Income Tax Service, page 93.]
- 3068** (6) Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private stockholder or individual. [See Art. 517 (1), Reg. 62, Income Tax Service, page 93.]
- 3069** A corporation organized and operated exclusively for the purpose of maintaining a symphony orchestra and giving musical concerts, the programs being of an educational character, and no part of the net earnings inuring to the benefit of any private stockholder or individual, is organized for "educational purposes." [See Art. 517 (2), (3), Reg. 62, Income Tax Service, page 93.]
- 3070** (7) Business leagues, chambers of commerce, or boards of trade, not organized for profit and no part of the net earnings of which inures to the benefit of any private stockholder or individual. [See Art. 518, Reg. 62, Income Tax Service, page 93.]
- 3071** (8) Civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare. [See Art. 519, Reg. 62, Income Tax Service, page 93.]
- 3072** (9) Clubs organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes, no part of the net earnings of which inures to the benefit of any private stockholder or member. [See Art. 520, Reg. 62, Income Tax Service, page 93.]
- 3073** (10) Farmers' or other mutual hail, cyclone, or fire insurance companies, mutual ditch or irrigation companies, mutual or co-operative telephone companies, or like organizations of a purely local character, the income of which consists solely of assessments, dues, and fees collected from members for the sole purpose of meeting expenses.
- 3074** It is necessary to exemption of organizations mentioned in the foregoing subsection (other than insurance companies, all of which are exempt) that the income of the company be derived solely from assessments, dues, and fees collected from members. [See Art. 521, Reg. 62, Income Tax Service, page 93.]
- 3075** (11) Farmers, fruit growers, or like associations, organized and operated as sales agents for the purpose of marketing the products



## CAPITAL STOCK TAX REGULATIONS.

of members and turning back to them the proceeds of sales, less the necessary selling expenses, on the basis of the quantity of produce furnished by them; or organized and operated as purchasing agents for the purpose of purchasing supplies and equipment for the use of members and turning over such supplies and equipment to such members at actual cost, plus necessary expenses. [See Art. 522, Reg. 62, Income Tax Service, page 93.]

**3076** (12) Corporations organized for the exclusive purpose of holding title to property, collecting income therefrom, and turning over the entire amount thereof, less expenses, to an organization which itself is exempt from the tax imposed by this title.

**3077** (13) Federal land banks and national farm-loan associations as provided in section 26 of the act approved July 17, 1916, entitled "An act to provide capital for agricultural development, to create standard forms of investment based upon farm mortgage, to equalize rates of interest upon farm loans, to furnish a market for United States bonds, to create Government depositaries and financial agents for the United States, and for other purposes."

**3078** Joint stock land banks created under the Federal farm loan act of July 17, 1916, are not exempt under this section.

**3079** (14) Personal service corporations. This subdivision shall not be in effect after December 31, 1921.

**3080** Personal service corporations so classified under the Revenue Act of 1918 are exempt from capital-stock tax for the taxable period July 1, 1921, to June 30, 1922, but are liable to capital-stock tax the same as other corporations effective July 1, 1922, under the Revenue Act of 1921.

**3081** Art. 30. Claims for exemption.—It may be stated generally that in all claims for exemption under the act, it is necessary that the claimant establish to the satisfaction of the commissioner that it is in practice *actually operated* in an exempt manner. In those cases falling under paragraphs of the statute requiring that the organization be "organized" or "organized and operated" in the manner specified, it is necessary also that the claimant establish to the satisfaction of the commissioner that it is so organized. The term "organized," as thus used, refers to the real substance and intent of the organization and not its mere form. In determining the real substance and intent of the organization the provisions of the charter and by-laws are not in themselves conclusive, but only *prima facie* evidence giving rise to presumptions according to their terms. The burden is upon the claimant to overcome these presumptions by extraneous evidence to the satisfaction of the commissioner.

**3082** Art. 31. Return by corporation claiming exemption.—As corporations are generally organized to do business every existing company is presumed to be subject to the tax unless satisfactory evidence is submitted showing that it is exempt. Corporations claiming exemption should fill out Form 707 but instead of computing the tax should enter in the space provided for the computation the notation "Exemption claimed." In all such cases the return so filled out must be filed with the collector, together with a comprehensive statement of the reasons for claiming exemption.

**3083** If exemption has been allowed for the preceding taxable year and there has been no change in the status or conditions of the company then the first 13 lines of Form 707 should be completed and a statement attached to the effect that exemption is claimed for the same reasons

## CAPITAL STOCK TAX REGULATIONS.

as for the previous year and that the same status and conditions of the company exist for the taxable period in question. In this way the records of the collectors' offices will be complete and corporations will avoid requests for the filing of returns and unnecessary correspondence. The determination of liability rests with the Commissioner of Internal Revenue and without complete information it is impossible to make a decision.

## ELECTION TO BE TAXED AS CORPORATION.

[¶1082.]

**3084 Art. 32. Election to be taxed as a corporation.**—In the event a business enterprise qualifies under the above provisions and elects to be taxed under Titles II and III as a corporation, then it is required to file capital stock tax returns and pay the tax for the six months' period, January 1 to June 30, 1921, and the 12 months' period, July 1, 1921, to June 30, 1922. The valuations for the first mentioned period will be reported as of December 31, 1920. The values for the last mentioned period will be reported as of June 30, 1921.

**3085** The clauses of section 1000 of the Revenue Act of 1918, which require that a corporation must have been engaged in business some part of the year preceding the taxable period in order to be liable for the tax, are not applicable to corporations filing returns under the provisions of section 229, of the Revenue Act of 1921.

## RETURNS PUBLIC RECORDS.

**3086 Art. 33. Inspection of returns.**—The returns upon which the tax has been determined by the commissioner, although public records, are in general open to inspection only to the extent authorized by the President. All bona fide stockholders of record owning 1 per cent or more of the outstanding stock of any corporation shall, upon making request of the commissioner, be allowed to examine the annual income returns of such corporations and of its subsidiaries, but such privilege of examination is personal and can not by power of attorney be delegated by the stockholder to another. Only such officers of any State as are charged with the enforcement of a State income tax law shall have access to the returns of any corporation, or to an abstract thereof showing the name and income of the corporation, at such times and in such manner as the secretary may prescribe, and then only in case the information is to be used by them in connection with such enforcement. Any stockholder who is allowed to examine the return of any corporation, and who makes known in any manner whatever not provided by law the amount or source of income, profits, losses, expenditures, or any particular thereof, set forth or disclosed in any such return, shall be guilty of a misdemeanor and be punished by a fine not exceeding \$1,000 or by imprisonment not exceeding one year, or both. [See Treasury Decisions 2961, 2962, 3273, and 3277 for full particulars. [See Inspection of Returns in The Income Tax Service.]

**3087 Art. 34. No authority for credit of excess payment of capital stock tax.**—Section 252 of the Revenue Act of 1921 provides for a credit against additional income taxes due to previous overpayments of income or excess-profits taxes. The law does not authorize the credit of an excess payment of capital stock tax for a given period against an assessment of



**CAPITAL STOCK TAX REGULATIONS.**

the same or other tax for a previous or subsequent period. A claim for abatement or refund for the excess assessment should be filed and payment made of the correct tax due for the previous or subsequent period.

**LAWS MADE APPLICABLE.**

[¶8000.]

**EXAMINATION OF BOOKS AND WITNESSES.**

[¶8002.]

**METHOD OF COLLECTING TAX.**

[¶8012.]

**3088 Art. 35. Time for payment of tax.**—All assessments shall be made by the commissioner. The collector shall within 10 days after receiving any list of taxes from the commissioner give notice to each corporation liable to pay any tax stated therein, to be left at its place of business or to be sent by mail, stating the amount of such tax and demanding payment thereof. If such corporation does not pay the tax within 10 days after the service or the sending by mail of such notice, it shall be the duty of the collector to collect the tax with a penalty of 5 per cent additional upon the amount of the tax and interest at the rate of one per cent a month. See section 3184, Revised Statutes. A collector has no authority to extend the time for payment of the tax, and any extension granted by him will be at his own risk. All taxes are payable direct to the collector of internal revenue of the district in which return is filed. The collector may accept payment of the tax when the return is filed as an "advance collection," subject to any adjustment later found necessary, but no corporation is required to pay the tax until after notice and demand. However, the collection of the tax is facilitated where a corporation transmits with the return a check for the amount of tax due. Tax due from a corporation which has liquidated is legally collectible from the stockholders or others who have received its assets.

**3089 Art. 36. Abatement and refund of taxes.**—Section 3220 of the Revised Statutes, as amended by section 1315 of the Revenue Act of 1921, provides [see ¶8023].

**FRAUDULENT RETURNS.**

**3090** Section 3225 of the Revised Statutes, as amended by section 1323 of the Revenue Act of 1921, provides [see ¶8047].

**MEDIUM OF PAYMENT OF TAX.**

**3091** Section 1325 of the act reads as follows [see ¶8020].

**3092 Art. 37. Payment of tax by uncertified checks.**—Collectors may accept uncertified checks in payment of taxes, provided such checks are collectible at par—that is, for their full amount, without any deduction for exchange or other charges. The collector will stamp on the face of each check before deposit the words, "This check is in payment of an obligation to the United States and must be paid at par. No protest," with his name and title. The day on which the collector receives the check will be consid-

**CAPITAL STOCK TAX REGULATIONS.**

ered the date of payment so far as the taxpayer is concerned, unless the check is returned dishonored. If one check is remitted to cover the taxes of two or more corporations, the remittance must be accompanied by a letter of transmittal stating (a) the name of the drawer of the check; (b) the amount of the check; (c) the amount of any cash, money order, or other instrument included in the same remittance; (d) the name of each corporation whose tax is paid by the remittance; (e) the amount of the payment on account of each corporation; and (f) the kind of tax paid.

**3093 Art. 38. Procedure with respect to dishonored checks.**—If the bank on which any such check is drawn shall refuse to pay it at par, the check shall be returned through the depository bank and be treated in the same manner as a bad check. All expenses incident to the attempt to collect such a check and the return of it through the depository bank must be paid by the drawer of the check to the bank on which it is drawn, since no deduction can be made from amounts received in payment of taxes. See section 3210 of the Revised Statutes. Any taxpayer whose check is not paid by the bank on which drawn becomes liable, under the terms of the law, for payment of the tax and for all legal penalties and additions, and the collector shall proceed to collect the same as though no check had been given. A taxpayer who tenders a certified check in payment for taxes is not released from his obligation until the check has been paid. (Act of March 2, 1911, 36 Stat. 965.)

**PENALTIES.**

[¶7693; ¶8014-8016.]

**3094 Art. 39. Doing business without payment of tax.**—Every corporation which does business without having paid the tax is liable to a penalty of \$1,000. A corporation paying the capital stock tax is not on that account exempt from any occupational tax.

**3095 Art. 40. Penalty for nonpayment of tax.**—(a) Any corporation which fails to pay the tax when due and payable is liable to a penalty of \$1,000. If it willfully refuses to pay or willfully attempts to evade the tax, it is liable also to a fine of \$10,000 and costs and to a 100 per cent penalty to be added to the tax. See also article 39. (b) Any officer or employee of a corporation who in the course of his duty fails to pay the tax when due and payable is liable to a penalty of \$1,000. If he willfully refuses to pay or willfully attempts to evade the tax, he is liable also to a fine of \$10,000 and costs and to imprisonment for a year, and to a penalty of the amount of the tax unpaid or evaded.

**3096 Art. 41. Penalties for failure to make return and for false return.**—Any corporation which fails to make a return within the required time is liable to a penalty of \$1,000. If it willfully refuses to make a return it is liable also to a fine of \$10,000 and costs.

**3097** Any officer or employee of a corporation who in the course of his duty fails to make a return within the required time is liable to a penalty of \$1,000. If he willfully refuses to make a return he is liable also to a fine of \$10,000 and costs and to imprisonment for a year.

**3098** In case of failure to file a return on time, a penalty of 25 per cent of the amount of the tax is added to it unless the return is later



**CAPITAL STOCK TAX REGULATIONS.**

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filed and failure to file it within the prescribed time is satisfactorily shown to the Commissioner to be due to a reasonable cause and not to willful neglect. This penalty is imposed by section 3176 of the Revised Statutes as amended. Two classes of delinquents are liable to this penalty: (a) Those who do not file returns and for whom returns are made by the collector or commissioner; and (b) those who file tardy returns and are unable to show reasonable cause for the delay. A taxpayer who files a tardy return and wishes to avoid the penalty must make an affirmative showing of all the facts alleged as a reasonable cause for failure to file the return on time in the form of an affidavit, which should be attached to the return. If such an affidavit is furnished with the return or upon the collector's demand, the collector, unless otherwise directed by the commissioner, will forward the affidavit with the return, and if the commissioner determines that the delinquency was due to a reasonable cause and not to willful neglect the 25 per cent penalty will not be assessed. If the taxpayer exercised ordinary business care and prudence and was nevertheless unable to file the return in the prescribed time, then the delay is due to "reasonable cause."

**UNNECESSARY EXAMINATIONS.**

[¶8006.]

**JURISDICTION OF COURTS.**

[¶8003-8005.]

**AMENDMENTS TO REVISED STATUTES.**

[¶8060.]

**COLLECTOR TO REPORT WILLFUL VIOLATIONS.**

[¶8061.]

**POWERS OF REVENUE OFFICERS.**

[¶8062.]

**PENALTIES FOR UNLAWFUL DISCLOSURES.**

[¶8063.]

**CANVASS FOR TAXABLE PERSONS AND OBJECTS.**

[¶8064.]

**RESPONSIBILITIES OF PERSONS LIABLE TO TAX.**

[¶8065 to ¶8070.]

**DELINQUENT RETURNS.**

[¶8071 to ¶8074.]

**FINAL DETERMINATIONS AND ASSESSMENTS.**

[¶8007.]

**ADMINISTRATIVE REVIEW.**

[¶8008.]

**RETROACTIVE REGULATIONS.**

[¶8011.]

**CAPITAL STOCK TAX REGULATIONS.****TIME FOR REFUND OF CAPITAL STOCK TAX.**

**3099** Section 3228 of the Revised Statutes is amended by section 1316 of the act to read as follows:

All claims for the refunding or crediting of any internal-revenue tax alleged to have been erroneously or illegally assessed or collected, or of any penalty alleged to have been collected without authority, or of any sum alleged to have been excessive or in any manner wrongfully collected, must be presented to the Commissioner of Internal Revenue within four years next after payment of such tax, penalty, or sum.

**3100** This section, except as modified by section 252, shall apply retroactively to claims for refund under the Revenue Act of 1916, the Revenue Act of 1917, and the Revenue Act of 1918.

**3101** Art. 42. Section 3228, R. S. (refunds), retroactive.—This section is retroactive in its effect. Any claim for the refund of taxes or penalties illegally assessed or collected under the Revenue Acts of 1916, 1917, or 1918, regardless of whether or not such claim was barred in whole or in part at the time of the passage of this act will be considered on its merits if presented within the four-year period specified in the foregoing section.

**LIMITATIONS UPON SUITS AND PROSECUTIONS.**

[¶8048-¶8055.]

**ASSESSMENTS.**

Sec. 1322. That all internal revenue taxes, except as provided in section 250 of this Act, shall, notwithstanding the provisions of section 3182 of the Revised Statutes or any other provision of law, be assessed within four years after such taxes became due, but in the case of fraud with intent to evade tax or willful attempt in any manner to defeat or evade tax, such tax may be assessed at any time.

**3102** Art. 43. Section 1322 R. S. (assessments) retroactive.—This section is retroactive in its effect. Under its terms capital stock taxes may be assessed at any time within a period of four years after such taxes became due, notwithstanding the fact that assessment may have been barred by a prior statute at the time of passage of the Revenue Act of 1921.

**3103** The new period of limitation embodied in the section also has the effect of extending for the same period the time within which the 25 per cent and 50 per cent penalties imposed by section 3176 of the Revised Statutes may be assessed.

**INTEREST ON REFUNDS AND JUDGMENTS.**

[¶8036-8037.]

**AUTHORITY FOR REGULATIONS.**

[¶8009.]

**REPEALS.**

[¶8076-8077.]

**3104** Art. 44. Promulgation of regulations.—In pursuance of the statute the foregoing regulations are hereby made and promulgated and all rulings inconsistent herewith are hereby revoked.

D. H. BLAIR,

*Commissioner of Internal Revenue.*

Approved June 15, 1922. [Released for publication June 22, 1922.]

A. W. MELLON,

*Secretary of the Treasury.*



(T. D. 3160.)

## Decision of the United States Court of Claims.

Act of September 8, 1916.

Washington Water Power Company vs. United States.

(February 14, 1921.)

**3105 1. Validity of tax.**—The capital stock tax is an excise tax imposed  
**3000** upon a corporation with respect to the carrying on or doing business  
 by the corporation, which is a proper subject for taxation by the  
 Government, and within its constitutional powers of taxation.

**3106 2. Payment in advance.**—The capital stock imposed by the Act  
 of September 8, 1916, is not illegal because assessed and collected in  
 advance under regulations of the Treasury Department, the act, by Sections  
 407 and 409, contemplating that a corporation must pay a tax on its capital  
 stock for the preceding year in order to do business for the coming year.

**3107 3. Action to recover tax paid—Maintenance.**—An action to recover a  
 capital stock tax paid in advance, on the ground that advance pay-  
 ment was unauthorized, cannot be maintained where the tax became due and  
 payable under the taxpayer's theory before suit was brought. (T. D. 3160,  
 April 30, 1921.)

## CAPITAL STOCK TAX REGULATIONS.

(Decision.)

Revenue Acts of 1916 and 1918.

(T. D. 3368.—281 Fed. 363.)

Certain trusts of the Massachusetts type are subject to capital stock tax.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE  
FIRST CIRCUIT.

No. 1551.

JOHN F. MALLEY, formerly Collector of Internal Revenue,  
Defendant, Plaintiff in Error,

v.

ARTHUR L. HOWARD ET AL., Trustees,  
Plaintiffs, Defendants in Error.

No. 1552.

ANDREW J. CASEY, acting Collector of Internal Revenue,  
Defendant, Plaintiff in Error,

v.

ARTHUR L. HOWARD ET AL., Trustees,  
Plaintiffs, Defendants in Error.

No. 1553.

JOHN F. MALLEY, formerly Collector of Internal Revenue,  
Defendant, Plaintiff in Error,

v.

ALVAH CROCKER ET AL., Trustees,  
Plaintiffs, Defendants in Error.

No. 1554.

JOHN F. MALLEY, formerly Collector of Internal Revenue,  
Defendant, Plaintiff in Error.

v.

LOUIS HECHT, JR., ET AL., Trustees,  
Plaintiffs, Defendants in Error.Error to the District Court of the United States for the  
District of Massachusetts.

**3108** ANDERSON, J. These cases involve the validity of taxes imposed  
**3015** upon business organizations, commonly known as Massachusetts  
 Trusts, under the Revenue Acts of 1916 (39 Stat. 789) and 1918  
 (40 Stat. 1057). Nos. 1551 and 1552 involve the Haymarket Trust and we  
 treat them as one case. The cases were argued as a group and may be con-  
 veniently dealt with in one opinion. The chief business of the Haymarket  
 and Hecht Trusts is that of owning, managing and leasing real estate, and  
 distributing the net income to its shareholders. These concerns deny that  
 they are associations within the meaning of the statutes.



**3109** The Crocker Trust is a large manufacturing concern. It admits that it is an association within the meaning of the statutes, but it claims immunity from the tax on the ground that it has no capital stock within their meaning.

**3110** The court below sustained the plaintiff's contentions in each case, and the government brought the cases here on writs of error.

**3111** The fundamental question is whether the plaintiffs are associations having a capital stock represented by shares, within the meaning of these provisions. So far as the issues in these cases are concerned, the provisions of the two statutes seem to us to be equivalent, for there is now presented no controverted question as to the amount of any tax; we therefore need not consider the different amounts exempt under the two statutes or the retroactive and substitutional effect of the 1918 statute.

**3112** The Act of 1916 levies a tax on associations "now or hereafter organized in the United States for profit and having a capital stock represented by shares . . . with respect to the carrying on or doing business by such association . . . equivalent to 50 cents for each \$1,000 of the fair value of its capital stock, and in estimating the value of capital stock the surplus and undivided profits shall be included. . . . The amount of such annual tax shall in all cases be computed on the basis of the fair average value of the capital stock for the preceding year,"—with an exemption not now material.

**3113** The Act of 1918, section 1, includes associations under the term "corporation"; and in section 1000 (a) provides for an annual "special excise tax with respect to carrying on or doing business equivalent to \$1 for each \$1,000 of so much of the fair average value of its capital stock for the preceding year," etc. "In estimating the value of capital stock the surplus and undivided profits shall be included."

**3114** Both acts are conceded to levy an excise tax with respect to doing business, the amount of the tax being measured by the average value of the capital stock, including any surplus and undivided profits as a part thereof. All the plaintiffs agree that they are doing business within the meaning of these acts.

**3115** While we recognize that in applying this and every other tax statute reasonable doubts must be resolved in favor of the taxpayer (*Gould v. Gould*, 245 U. S. 151) yet revenue acts are not penal statutes; the Government is not to be crippled by strained and unnatural construction of tax statutes fairly plain.

*Cliquot's Champagne*, 3 Wall. 114, 145.

*United States v. Hodson*, 10 Wall. 395.

*Worth Brothers v. Lederer*, 251 U. S. 507.

**3116** Taxation of this general kind began with the passage of the Act of August 5, 1909 (36 Stat. 11, 112), which imposed a tax "on every corporation, joint-stock company or association organized for profit and having a capital stock represented by shares . . . now or hereafter organized under the laws of the United States or of any state or territory . . . with respect to the carrying on or doing business by . . . such corporation, joint-stock company or association . . . equivalent to one per cent upon the entire net income over and above \$5,000," etc.

**3117** This statute, passed before we had the 16th amendment, was attacked as an income tax and therefore unconstitutional. But the Supreme Court held that it was not an income tax, and sustained it as an excise tax.

*Flint v. Stone Tracy Co.* (1911), 220 U. S. 107. It was measured by the income,—not as under the present law, on the capital used.

**3118** In *Eliot v. Freeman*, 220 U. S. 178, the court at the same time held the Act of 1909 not to cover two typical Massachusetts real estate trusts, on the ground that, “The language of the act, ‘now or hereafter organized under the laws of the United States,’ etc., imports an organization deriving power from statutory enactment.” Organized as purely non-statutory, they were exempt.

**3119** The gist of the present case is whether the statutes of 1916 and 1918 are, as the plaintiffs contend, to be given the same interpretation in favor of exempting such organizations as was given by the Supreme Court to the Act of 1909.

**3120** The government, on the other hand, contends that the language of the acts is plainly applicable to such organizations; that the history of the legislation shows that Congress intended to avoid the result reached in *Eliot v. Freeman*, *supra*, and that there are no applicable decisions of the courts supporting the plaintiffs’ position. We think the government is right, and that the court below erred in holding that such organizations are not associations within the meaning of these Revenue Acts.

**3121** The language of the statutes, *supra*, seems so plain that repetition and paraphrasing would add nothing.

**3122** The history of the legislation lends emphasis to the initial impression of its import. For it is elementary, that when language used in an earlier statute has in application received judicial construction, change in language in later analogous legislation imports legislative purpose to attain a different result. If Congress had intended the acts in question to have the restricted application given by the Supreme Court to the Act of 1909, there was no conceivable reason for changing the words “organized under the laws of the United States or of any state,” etc., etc., to “organized in the United States.”

**3123** We think it plain that by this change Congress intended in the later acts to include non-statutory organizations, and to avoid the restrictions found by the Supreme Court in the words of the 1909 act. We cannot accord with the learned District Judge in his view that “it is hard to discover any substantial distinction between the scope of” the Act of 1909 and the Acts of 1916 and 1918 “as far as ‘associations’ are concerned.” We think there is a vital and controlling distinction.

**3124** *Eliot v. Freeman* was decided in 1911. In 1913 an income tax act was passed (38 Stat. 114, 166), imposing such tax “on every corporation, joint-stock company, or association, and every insurance company organized in the United States, no matter how created or organized, not including partnerships.” The original case of *Crocker v. Malley*, 249 U. S. 223, the plaintiffs’ chief reliance, arose under this statute. Sitting as District Court, Judge Bingham, in July, 1917, held the Wachusett Realty Company, the predecessor of the present Crocker Association, a trust, according in that regard with Judge Hale in a decision made on May 23, 1914, in the case of *Crocker v. Crocker*.

**3125** But in this court (250 Fed. 817) the organization was held an association within the meaning of the statute. The Supreme Court reversed this court, adopting the view of the District Court. The decisions, both in the Supreme and District Courts, against the government, turned upon the fact that the shareholders had no real control over the trust estate;



so that it therefore fell within the doctrine of *Williams v. Milton*, 215 Mass. 1 from the opinion in which Mr. Justice Holmes quoted (249 U. S. 232) as follows:

"There can be little doubt that in Massachusetts this arrangement would be held to create a trust and nothing more. 'The certificate holders . . . are in no way associated together, nor is there any provision in the [instrument] for any meeting to be held by them. The only act which (under the [declaration of] trust) they can do is to consent to an alteration . . . of the trust' and to the other matters that we have mentioned. They are confined to giving or withholding assent, and the giving or withholding it 'is not to be had in a meeting, but is to be given by them individually.' 'The sole right of the *cestuis que trust* is to have the property administered in their interest by the trustees, who are the masters, to receive income while the trust lasts, and their share of the corpus when the trust comes to an end'."

**3126** The trustees of the Wachusett concern held title, subject to a long lease, to eight mills, and to the stock of the corporation operating these mills, and distributed the net income to the eight beneficiaries of the trust. The trustees were not managing the mills; the organization was not a business enterprise within the normal use of that term. The beneficiaries were "admitted not to be partners in any sense . . . have no joint action or interest and no control over the fund." 249 U. S. 234. The court, in referring to the phrase in the statute "no matter how created or organized," says:

"The trust that has been described would not fall under any familiar conception of a joint-stock association, *whether formed under a statute or not.*" Citing *Smith v. Anderson*, 15 Ch. Div. 247, 273, 277, 282.

**3127** Moreover, the tax then sought to be sustained was levied, at least in substantial part, in respect of dividends received from a corporation that itself was taxable upon its net income. The court therefore held that "as the plaintiffs undeniably are trustees, if they are subjected to a double liability the language of the statute must make the intention clear. *Gould v. Gould*, 245 U. S. 151, 153."

**3128** It is thus apparent that the Wachusett Realty Company was in organization and purpose but an ordinary *inter vivos* trust for eight beneficiaries; also that the tax sought to be imposed would have resulted in double taxation, never easily inferred. It was in nature, and in relations to its shareholders and to society at large, radically different from the plaintiff's organizations, described below. That decision lends no support to the plaintiffs' contention.

**3129** Next in chronological order was the stamp tax provision of the Act of October 22, 1914 (38 Stat. 745, 775). This act imposed a stamp tax on "each original issue . . . of certificates of stock by any association, company or corporation." This court in *Malley v. Bowditch*, 259 Fed. 809, held such tax applicable on the original issue of certificates or shares of the Pepperell Manufacturing Company "a manufacturing company organized in the form of a trust under the common law, and deriving none of its rights, qualities or benefits from any statute." The crucial question in that case, as in the case at bar, was whether the organization was an association within the meaning of the Federal Tax Act. The case is, in essentials, difficult, if not impossible, to distinguish from the cases at bar. The cogent opinion of Judge Brown is applicable to most aspects of the present problem. It might well be quoted from at length.

**3130** The Revenue Acts of 1916 and 1918, *supra*, both in their income and excise tax provisions, adopt the same broad phrasing as to joint stock companies or associations "organized in the United States," thus showing a continuing legislative purpose to avoid the limitation found by the Supreme Court in *Eliot v. Freeman*, *supra*, arising out of the language "organized under the laws of the United States or of any state," etc.

**3131** Plainly, there is nothing in this history of legislative and judicial dealing with the matter, lending support to plaintiffs' contention that Congress intended to exempt such business organizations as the plaintiffs. Rather does the history support the natural construction of the acts in question.

**3132** We find nothing else in the history of the legislation concerning this and analogous forms of taxes, nor in other cases cited, tending to uphold the plaintiffs' contentions or otherwise calling for analysis and discussion.

**3133** A brief description of the three plaintiffs' organizations will conveniently precede our final considerations. We take first the Hecht case, agreeing with learned counsel that it is the strongest case for the plaintiff.

**3134** On superficial examination, this organization looks somewhat like a family affair, making provision for members of the Hecht family, immature or otherwise unfitted for business responsibilities. But, on analysis, we find the organization is a very genuine business concern.

**3135** In 1899, members of the Hecht family holding as tenants in common real estate on Federal Street and Atlantic Avenue, Boston, conveyed it to Jacob Hecht, who declared a trust for twelve beneficiaries all named Hecht, who received certificates transferable like ordinary corporation shares, but with a restriction in favor of lineal descendants of Elias Hecht, and, on certain contingencies not now important, to be offered to the trustee before sold to an outsider. The restriction is analogous to the close-corporation provision dealt with in *New England Trust Co. v. Abbott*, 162 Mass. 148. It is in no way peculiar to a trust as distinguished from a corporation. While the Hecht trustee has broad general powers of management, including power to buy and sell, the seat of real power is with the shareholders and not with the trustee; for three-fourths of the shareholders may remove the trustee, three-fifths may terminate the trust or give him binding instructions, and also, —what is of vital importance,—*modify the instrument in any particular*. This power to modify covers, potentially, the right to extend or change the business so as to make it as large and as corporate in form and function as the Crocker concern, which admits that it has evolved into an association. The Hecht organization is not a trust within the doctrine of the Massachusetts decisions. *Williams v. Milton*, 215 Mass. 1. Compare *Crocker v. Malley*, 249 U. S. 223; *In re Associated Trust*, 222 Fed. 1012. The Hecht trustee has made annual statements showing the assets, liabilities and net income, and kept books, containing a capital account and surplus account. Its stockholders have, sensibly and we think legally, treated their dividends like corporation dividends, in their income tax returns. They have thus by conduct, presumably under the advice of counsel, denied that they are partners taxable under the Act of 1918, sec. 218 (a).

**3136** Parenthetically, we note that counsel do not contend that the shareholders of any of these plaintiff associations are partners. There is no suggestion that any of the shareholders in any of the plaintiff organizations have made, propose to make, or could make, tax returns as partners in these



business concerns. Manifestly, counsel would deprecate such result as imposing burdens probably much heavier,—certainly difficult if not impossible of ascertainment,—upon the shareholders in such organizations. Their quest is tax exemption, not tax substitution. Compare *Dana v. Treasurer*, 227 Mass. 562, 565; *Frost v. Thompson*, 219 Mass. 360.

**3137** Plainly the Hecht Trust is quasi-corporate in form and power. It is an association within the meaning of the Revenue Acts.

**3138** The Haymarket Trust, both in genesis and organization, is even more like a corporation. It has none of the aspects of a family affair. It started by securing from the investing public \$250,000 on solicited subscriptions, the trustee paying a commission of \$2,500 to the promoter for thus raising the capital for doing business. The declaration of trust provides for nearly all the machinery and proceedings of an ordinary corporation. We hold it also to be quasi-corporate and an association within the meaning of the Revenue Acts.

**3139** Learned counsel in the Croker case admit that it is an association, but claim exemption on the ground that the concern has no capital stock. This association was evolved from the Wachusett Realty Trust, above referred to. As there pointed out, the shareholders had under the Wachusett declaration no power to amend without the assent of the trustees. But in June, 1917, shareholders and trustees both agreeing, the organization was radically altered. Its name was changed and in express terms it agreed that its form should thereafter be "changed to that of an association," with power to take over and carry on the extensive manufacturing business previously carried on by the corporation whose stock it had held, or any substantially similar business.

**3140** The new organization conforms closely to the corporation model,—in powers, in official personnel, and in methods of doing business. It has issued 96,000 shares of no par value, transferable like corporation stock, but with a restriction somewhat like that in the case of *New England Trust Co. v. Abbott*, *supra*.

**3141** Conceding that it is an association with transferable shares, this plaintiff yet seeks exemption on the ground that it has attached no par value to its 96,000 shares. It admits that if it had attached a par value of, say, \$100 to each of these shares, making a capital account of \$9,600,000, a little less than is shown on its balance sheet of July 1, 1917, where the interest of the shareholders is put down as \$9,877,105.16,—the concern would have had a capital stock represented by shares, and thus be an association within the meaning of the Revenue Acts above.

**3142** We cannot adopt this scholastic and artificial distinction. Cf. *Worth Bros. v. Lederer*, 251 U. S. 507, 510. It is for present purposes immaterial whether the stock of a corporation, of an association, or a joint-stock company has or has not par value. Compare Gen. Laws of Mass. chap. 156, secs. 14, 15, 47. Stockholders, whether a definite value is or is not attributed to their shares, severally or in mass, own beneficially the net value of the corporation's assets,—that is, whatever may remain after discharging debts.

See *Hood Rubber Co. v. Commonwealth*, 238 Mass. 369, 371.

Cook—"Stock Without Par Value," Am. Bar Ass'n Journal, October, 1921.

Hollen and Tuthill "Stock Having No Par Value," Am. Bar Ass'n Journal, November, 1921, p. 578.

Colton "Par Value v. No Par Value Stock," Am. Bar Ass'n Journal, December, 1921, p. 671.

Compare also *Eisner v. Macomber*, 252 U. S. 189, 209 *et seq.*

**3143** Congress intended that this tax should be measured by the average amount of capital used during the tax year in doing the business. The phrase in the statutes as to "including surplus and undivided profits" puts beyond doubt the question of the Congressional intent to measure this tax by business and financial realities, not by book-keeping forms or mere names. "Fair value" and "fair average value" carry the same notion. Cf. *Wright v. Georgia R. R. et al.*, 216 U. S. 420, 424.

**3144** The Croker Association cannot escape taxation, falling on its competitors, by adopting the modern theory of no par value for its stock. The presumption is against such immunity; it savors of special privilege. Compare *United States v. Dickson*, 15 Pet. 141, 165.

**3145** It is a matter of common knowledge that, for most business and financial purposes, all the larger organizations of this sort have for years been indistinguishable from corporations. One might almost say that they are a device under which parties make their own corporation code. Business concerns so organized have come to occupy a large field in industry and in finance. At least two substantial text-books have been written on the law concerning such organizations and dealing with their advantages for general business purposes. See *Sears, Trust Estates as Business Companies*, 1st Ed. 1912, 2d Ed. 1921. Note the long list of industries so organized referred to on pages VI and VII of the preface of the 1921 edition. See *Wrightington on Unincorporated Associations*, 1916. In *Dana v. Treasurer*, 227 Mass. 562, 565, it appears that the Amoskeag Manufacturing Company, commonly known to be one of the largest enterprises in New England, is so organized. The Pepperell Manufacturing Company, before this court in *Malley v. Bowditch*, *supra*, had a capitalization of over \$7,500,000; the Crocker Trust operates large paper manufacturing mills, employing about 1,000 men, with gross assets of over \$10,000,000.

**3146** Such concerns have long been recognized as quasi-corporate in form. In 1904, Chief Justice Knowlton in the Massachusetts Supreme Court said of a typical one of them, in *Hussey v. Arnold*, 185 Mass. 202:

"The agreement creating the trust has peculiar provisions. The object of it, apparently, was to obtain for the associates most of the advantages belonging to corporations, without the authority of any legislative act, and with freedom from the restrictions and regulations imposed by law upon corporations."

**3147** No amplification of words could more accurately and adequately characterize this sort of business organization. Other cases in the Massachusetts reports concerning them abound in similar observations as to their resemblance to corporations. *Williams v. Milton*, 215 Mass. 1, and cases cited. See *Williams v. Boston*, 208 Mass. 497; *Phillips v. Blatchford*, 137 Mass. 510, 515; *Tyrrell v. Washburn*, 6 Allen, 466, 474.

**3148** But the proposition that they are quasi-corporate in form need not rest merely on our own analysis or on observations found in the decisions of the Massachusetts courts. It has now been distinctly recognized by the Massachusetts legislature; they have a statutory status as *associations*, not as trusts or as partnerships.

**3149** In the decision below, these organizations have been treated as having no status not arising out of the common law; so also in the briefs of the government and of counsel for the defendant. It seems to have been overlooked that they have acquired in Massachusetts a distinct statutory



basis. This, if the question before us were otherwise doubtful, would seem to us of much significance. See General Laws of Mass. (1921), c. 182, codifying earlier legislation of 1909, 1913, 1914, 1915, and 1916. Compare also Acts of 1921, c. 368. The title of this chapter is "*Voluntary Associations.*"

**3150** In section 1 of this act, dealing with definitions, it is provided: "‘Association,’ a voluntary association under a written instrument or a declaration of trust, the beneficial interest under which is divided into transferable certificates of participation or shares." This definition exactly fits the plaintiffs at bar.

**3151** In section 2, it is provided that the written instrument or declaration creating the association shall be filed with the Commissioner of Corporations, and with the clerk of every town where such association has a usual place of business. Section 5 requires the Commissioner to transmit to the Secretary of State copies of such instruments or of any amendments filed during the previous year, to be printed as a public document. The instruments creating such associations are thus made even more generally accessible than are ordinary corporation charters.

**3152** Sections 3 and 4 and 7 to 11 deal specially with associations owning stock of public utility companies; they need no present comment.

**3153** Section 6,—a re-enactment of the Act of 1916, c. 184, passed subsequent to all the Massachusetts decisions cited and relied upon by the plaintiffs,—has probably the most direct bearing on our present problem; it is as follows:

"An association may be sued in an action at law for debts and other obligations or liabilities contracted or incurred by the trustees, or by the duly authorized agents of such trustees, or by any duly authorized officer of the association, in performance of their respective duties under such written instruments or declarations of trust, and for any damages to persons or property resulting from the negligence of such trustees, agents or officers acting in the performance of their respective duties, and *its property shall be subject to attachment and execution in like manner as if it were a corporation*, and service of process upon one of the trustees shall be sufficient."

**3154** Here is a distinct enactment that such *associations* shall be suable *in like manner as if corporations*. An organization described as an *association* and made generally liable "to attachment and execution in like manner as if it were a corporation" cannot easily be held a partnership or a trust.

**3155** We are not called upon to deal with the confusing and perhaps irreconcilable decisions in the Massachusetts courts concerning the nature and legal incidents of these associations, most of which were made before the passage of this Act of 1916, or with the effect of this legislation upon their powers and liabilities,—except so far as pertains to our single problem of determining whether these associations are liable to Federal taxation under the Revenue Acts, *supra*. We intimate no opinion on any other question. But when a Massachusetts statute has described such organizations as *associations*, and has put their liability to ordinary creditors apparently on the same basis as that of corporations, we have no hesitation in reaching the conclusion that they have now been given a *statutory basis as quasi-corporate*, and that they are associations within the meaning of the Federal Statutes, as well as under the Massachusetts Statutes. We cannot hold Massachusetts *associations*, liable under Massachusetts Statutes to ordinary creditors as though corporations, not liable under Federal Statutes

to taxation imposed generally on corporations, joint-stock companies and associations.

**3156** It may be argued that these statutes are distinguished from corporation acts in that their chief functions are to regulate or restrict, whereas corporation acts also empower. Technically, that may be so. But the powers of these voluntary associations are in many respects greater, and the regulations and restrictions less, than in the case of corporations. Broadly speaking, their promoters select and define such powers and provide such limitations of liability, as they desire. Cf. *Hussey v. Arnold*, *supra*. If and in so far, therefore, as the tax in question is directed at "the privilege" or power of doing business through large organizations,—and particularly at the power to obtain money from the outside public on transferable shares,—voluntary association offers at least as much "privilege" as does any corporation form of organization. Associations are resorted to, not because thought weaker, but because thought stronger, than corporations.

**3157** If, in construing the statutes, we may look at the policy Congress probably desired to adopt, it could not be overlooked that the plaintiffs' contention, if sustained, would amount to a discriminatory immunity in favor of a kind of business organization, the nature and activities of which have hitherto been the subject of much question and investigation. See the Report of the Tax Commissioner of Massachusetts on Voluntary Associations, under Resolves of 1911, c. 55,—a very interesting document,—in which Commissioner Trefry ably reviewed their origin, history and legal incidents, both in England and in this country; referring, *passim*, and particularly on page 13, to many other documents and legislative reports concerning them. See also a report of the Special Commission to Investigate Voluntary Associations, January, 1914, made under Mass. Resolves of 1912, c. 113. In the Resolve of 1911, c. 55, the Commissioner was required to make an investigation "with a view to determine" *inter alia*, "whether . . . their prohibition . . . is advisable in the public interest."

**3158** There is, we think, no conceivable reason why Congress should have desired to favor organizations of this questioned sort by exempting them from taxation to which their competitors in corporate form are subjected. The presumption is plainly the other way. Modern corporation laws furnish adequate machinery for carrying on every legitimate form of business, including now that of dealing in real estate. See Gen. Laws of Mass. chap. 156, *passim*; sec. 7, authorizing real estate corporations. There is no present reason for resorting to this form of organization, except on the theory that more "privileges of doing business" may be thus acquired than by conforming to our broad and elastic corporation laws. To hold that Congress intended to discriminate in their favor would be to disregard the letter, the spirit and the reason of the acts.

**3159** Our views accord with those expressed by Judge Page in *Chicago Title & Trust Co. v. Smietanka*, 275 Fed. 60. The reasoning of Judge Morton in the *Associated Trust* case, 222 Fed. 1012, where he reached the conclusion that such an association was an "unincorporated company" within the meaning of the Bankruptcy Act, seems to us to sustain our conclusions rather than those reached by the learned Judge in the instant cases.

**3160** We summarize our conclusions as follows:

- (1) The natural interpretation of the language used in the Acts of 1916 and 1918 would include plaintiffs' organizations as associations.
- (2) The contrast between the language used in the Act of 1909 "organized



under the laws of the United States or any State"; etc., and in the Act of 1916 and 1918 "organized in the United States," shows that Congress intended to avoid the result reached in 1911 by the Supreme Court in *Eliot v. Freeman*.

(3) The manifest general purpose of Congress was to tax business deriving powers and making profits from association, particularly business done by organizations getting all or a substantial part of their capital on transferable shares, such as are commonly sold to the investing public.

(4) Prior to the passage of either the Revenue Act of 1916 or 1918, the Massachusetts Legislature had by the Acts of 1909 and 1914 expressly recognized such organizations as associations. Congress used the word "association" as the Massachusetts Legislature had previously defined and used it.

(5) By the Act of 1916, the Massachusetts Legislature made such associations liable to creditors in like manner as if corporations; by analogy they have similar liability to the Federal Government for taxes.

(6) The case of *Malley v. Crocker*, 249 U. S. 223, makes, on analysis of the Wachusett Trust and the reasoning of the court, not for the plaintiffs but for the government. One ground of that decision was to avoid unjust, discriminatory, double taxation; whereas, to sustain the plaintiffs' contention, would create discriminatory immunity for a large class of business organizations, thus giving them an unfair advantage over their incorporated competitors.

(7) The conclusion now reached accords with the reasoning and decision of this court in *Malley v. Bowditch*, 259 Fed. 809.

*In each case the judgment of the District Court is reversed and the case is remanded to that court for further proceedings not inconsistent with this opinion; the plaintiff in error recovers costs in this court.*

**3161 Cases reported above are in the U. S. Supreme Court: Malley vs. Howard being No. 533, Casey vs. Howard being No. 534, Malley vs. Crocker being No. 587, and Malley vs. Hecht being No. 532, all October Term, 1922.**

*(Decision)*

Revenue Act of 1916. Equally applicable to 1918 and 1921 Acts.

May 25, 1922.

[T. D. 3359.]

As the measure of the tax the fair average value of the capital stock of a corporation is the equivalent of the fair average value of the enterprise in its entirety as a going concern.

DISTRICT COURT OF THE UNITED STATES FOR THE  
SOUTHERN DISTRICT OF NEW YORK

Central Union Trust Company of New York, Plaintiff,

vs.

Wm. H. Edwards, Collector of Internal Revenue for the  
Second District of New York, Defendant.

Memorandum Opinion.

**3162** GRUBB, J.—This case presents for decision of meaning of the words  
3001 “capital stock,” used in Section 407 Title IV Excise Tax Act of  
3034 September 8, 1916. The Plaintiff contends that the true meaning  
of the words is the paid in capital, together with surplus and undivided profits, less liabilities; or the net value of the capital assets of the corporation, after deducting its debts. The Collector applied a different method of reaching the value of the “capital stock” of the plaintiff corporation, and one which increased the amount of the tax due over that which would have been due according to the method contended for by the Plaintiff. If the method contended for by the Plaintiff is not a correct one, the Plaintiff offers no criticism of that actually adopted by the Collector; so that the single question presented is whether the method, for which the Plaintiff contends is the only proper one under the statute.

**3163** The method, which the Plaintiff says should have been adopted by the Collector in measuring the tax, takes into consideration only the net worth of the tangible assets of the corporation, and does not take into consideration such elements as franchises, good-will, existing contracts, and established business. The tax imposed by the statute is not a property tax. It is an excise tax imposed upon the privilege of doing business in corporate form, as a going concern. The value of this privilege is the obvious way to measure the tax. The value of the business of a going concern depends upon its good-will, favorable contracts, amount of business done and its profitable character; as well as upon the value of its tangible property less its debts. It would seem wrong to eliminate these factors of value, if the tax is to be measured by the value of the enterprise as a going concern. They enter into the market value of the share stock, and are represented in the earning capacity of the corporation. It would therefore seem to be competent for the Collector to consider, in estimating the value of “capital stock,” in addition to the net worth of the corporation, as shown by its books, such elements of intangible value as good will, favorable contracts, amount and character as to profits of the business done, and also past earnings and the market value of the stock. The method insisted upon by the Plaintiff as being the only correct one, would eliminate all these factors from the computation, and base it exclusively upon the paid in capital, together with



surplus and undivided profits. The character of the tax and the subject matter of its imposition seem to me to forbid such an exclusion unless it is made necessary by the language of the statute itself.

**3164** If the words "capital stock" had but one meaning, viz:—the money paid and property contributed to the corporation by its shareholders, the Plaintiff's contention that by the unambiguous terms of the statute, only paid in capital together with surplus and undivided profits could be considered in the measurement of the value upon which the tax is estimated, would be correct. The words "capital stock" have been so construed by some authorities, when employed in statutes imposing taxes. It is also true that they have by other courts been construed to have a different and broader meaning, when used in acts of the same character. The conclusion to be drawn from the authorities would seem to be that the signification to be accorded these words is to be determined in each such act, by the character of the particular act under construction and by the language used and by the context. They may mean either net worth, as shown by the books, i. e., the value of the tangible corporate assets, less liabilities; or they may mean the value of the entire enterprise as a going concern, including franchises, good-will, etc., as represented by the excess value of the market price of the share stock over and above its book value. In each act, the meaning of the words is to be ascertained by reference to the language used and to the purpose of the act containing them.

**3165** The act in question provides for the annual payment of "a special excise tax with respect to the carrying on or doing business by such corporation, equivalent to fifty cents for each one thousand dollars of the fair value of its capital stock and in estimating the value of its capital stock the surplus and undivided property shall be included. . . . the amount of such annual tax shall in all cases be computed on the basis of the fair average value of the capital stock for the preceding year." The words employed indicate rather an appraisal of the value of the "capital stock" arrived at by considering various factors of value, by the exercise of judgment; than an auditor's exact determination of the value of the net worth of tangible assets, taken from the corporate books of account. If the value of good-will and franchises, earnings and market value of shares, are eliminated as factors of value, then the computation of value would in no sense be an estimation; the value would be the exact value rather than the fair value; and it would have been made determinable as of the end of a fiscal year, rather than by "the fair average value of the capital stock for the preceding year."

**3166** The act provides that "in estimating the value of capital stock the surplus and undivided profits shall be included." Plaintiff contends that these words restrict the computation to the par value of the capital stock, plus surplus and undivided profits. I think the purpose of the insertion of these words was to make certain that these two factors should be considered, but not to eliminate other factors equally as important. If the purpose was to so narrow the elements to be considered, there was apt language to accomplish this purpose in previous congressional legislation. Act of Congress, October 22, 1914—Section 3.

**3167** The language and context seem more favorable to the defendant's interpretation than to that of the Plaintiff, since they imply an estimation to be based on judgment exercised, rather than the mere computation of an accountant.

**3168** The legislative discussion of the Act upon the floor of the House of Representatives and the statements of the Chairman of the Com-

mittee in charge of the Bill, are persuasive that the Defendant's construction, was that which was in the minds of the legislators. Congressional Record—House of Representatives, September 7, 1916, 64th Congress—First Session, Vol. 53, part 13, page 14,118.

**3169** After the Act of September 8, 1916, had received from the Commissioner of Internal Revenue, the construction now contended for by the Defendant, Congress enacted the Revenue Act of 1918, containing Section 1000-a, in the same language as of Section 407 of the Act of September 8, 1916, except that the rate was doubled and the deduction lowered. The Senate had amended the House bill, so as to make the basis of the tax the amount of the net assets shown on the books as of the close of the preceding income tax year. This amendment was rejected by the House, and the Senate receded from it in conference. This is persuasive that the words "fair average value of the capital stock" were not thought by that Congress to be synonymous with the net worth of physical assets as shown by the corporate books.

**3170** For the reasons stated, I do not think the construction advanced by the Plaintiff is a correct one. I believe the Collector was confronted with the proposition of determining the value of the corporation's business and property as an entirety and as a going concern, and in doing so had the right to look to the net worth of the corporate assets, including its surplus and undivided profits, as shown by its books; also to the franchises, good-will, outstanding contracts, the earning capacity of the corporation and the market value of its share stock over the preceding year, and, after having done so, was authorized to arrive at a value for its entire capital stock, representing the enterprise as a going concern, according to his best judgment; and that the value, so ascertained, would be the "fair average value of the capital stock for the preceding year," by which the tax by the terms of the statute is to be measured. This the Collector did, and this conclusion requires the direction of a verdict in favor of the Defendant, and it is so ordered.



## CAPITAL STOCK TAX REGULATIONS.

(Decision.)

Revenue Act of 1916. Equally applicable to 1918 and 1921 Acts.  
January 8, 1923.

As a measure of the tax the fair average value of the capital stock of a corporation is the equivalent of the fair average value of the enterprise in its entirety as a going concern.

UNITED STATES CIRCUIT COURT OF APPEALS  
FOR THE SECOND CIRCUIT.

Central Union Trust Company of New York,  
Plaintiff-in-error,  
against  
William H. Edwards, Collector of Internal Revenue for the  
Second District of New York,  
Defendant-in-error.

*Writ of error to judgment entered in the District Court for the Southern District of New York.*

**3171** The United States assessed a tax against plaintiff pursuant to Section 3162 407 of the Revenue Act of 1916 (39 Stat., 756, 789-790).

**3172** The applicable language of that statute is as follows:

"Every corporation, joint stock company or association now or hereafter organized in the United States for profit and having a *capital stock represented by shares* \* \* \* shall pay annually a special excise tax with respect to the carrying on or doing business by such corporation \* \* \* equivalent to fifty cents for each \$1,000 of the *fair value of its capital stock*, and in estimating the value of capital stock, the surplus and undivided profits shall be included. \* \* \* The amount of such annual tax shall in all cases be computed on the basis of the *fair average value* of the capital stock for the preceding year."

**3173** The tax assessed was based upon undisputed facts, whereof we regard the following as crucial, viz.: at date of return the par of plaintiff's capital stock was \$5,000,000, its surplus \$15,000,000, and its average undivided profits (in round numbers) \$2,000,000; the par value of each share was \$100, and the book values upwards of \$400; for five years prior to return, dividends had annually been declared of never less than 50 per cent, and during the year preceding return the average market price of each share of stock sold was \$788.75. Good will is not carried as an asset.

**3174** A tax was admittedly due in an amount equal to 50 cents for each \$1,000 of the aggregate of its outstanding capital stock, surplus and average undivided profits, less the statutory deduction. In other words the tangible book assets were used as the basis for tax computation.

**3175** The Commissioner of Internal Revenue assessed a tax reached by using as basis for computation, what defendant calls the "Fair value of total capital stock, *i. e.*, 50,000 shares at \$575.97 per share."

**3176** The additional tax resulting plaintiff paid under protest, and brought this action to recover. The trial court directed judgment for defendant [¶3170]; this writ followed.

Arthur H. Van Brunt for plaintiff-in-error;  
Richard S. Holmes, Special Ass't U. S. Attorney, for defendant-in-error.

**3177** Hough, C. J.—Admittedly the statute created an excise or privilege tax, not one directly laid on property. Admittedly also the tax is to be measured by property; and it states the philosophy or fundamentals of this difference between the Treasury and the taxpayer, to enquire—Whose property? That of the Trust Company, or that of its shareholders?

**3178** If one is to pay a tax measured by property, it assuredly seems more consonant with philosophical jurisprudence to measure the same by the property of the taxpayer, rather than by the possessions of another. But taxes are not philosophical products; they result from an assumed necessity, and their incidence is determined by probable ease of collection, politics or partisanship, and other consideration of convenience or emotion.

**3179** Since it is familiar law that only the results of legislative action and not the motives of the legislators are fit subjects for judicial enquiry, it follows that any and every system of tax-laying prescribed by competent authority must be given its intended scope, if by any reasonable interpretation of the words used that end can be reached, and no constitutional limitations are infringed.

**3180** This reduces the present enquiry to the question whether Congress meant that in measuring this excise tax, regard should be had only to what the corporation owned in its corporate capacity, and capable of admeasurement permitting entry on its books of account, *i. e.*, its tangible assets; or whether there should be taken into consideration the public opinion, reflected by the open market, of what it was worth to share in the handling of those tangible assets, *i. e.*, its good will, good management and established capacity for earning profit.

**3181** But no subject can long be treated by legislatures and courts without developing a technique, and converting words of frequent use into formulae; so that statutory interpretation is often, if not usually, a search after the permitted meanings of certain words, commonly used yet often used without any knowledge of the legal formulae by which they may be surrounded.

**3182** Thus the formal question at bar is—what did Congress mean by “the fair value of its capital stock,” as applied to a company of which its shareholders think so highly that they regard each share as worth nearly twice what they would get for it on liquidation in accordance with honestly and intelligently kept books.

**3183** If “capital stock” is a phrase regularly given in legal formulae a fixed, definite and certain meaning, that meaning is oftentimes conclusively presumed to be what Congress meant in the premises; and what the legislators or most of them intended to accomplish by the phrase is immaterial.

**3184** Accordingly this taxpayer urges that “capital stock” in taxation nomenclature means nothing but “capital,” *i. e.*, tangible assets only, as shown by unimpeached books, and the reason for such meaning is that such assets are the property, and the sole property of the corporation divorced from its right to transact business in its accustomed manner, *viz.*: franchise and goodwill.

**3185** That past generations of corporate taxation, and of contests over the same have produced any general consensus of judicial or legislative opinion on this subject we cannot think true.

**3186** There is certainly no authority limiting Congress to this meaning, while the states display the usual variety in opinion.

**3187** To give illustrations, without exhausting search: New York has not departed from *People vs. Coleman* 126 N. Y., 433, and holds that “capital



stock" of a corporation signifies what is owned and held by the Company in its corporate character; into which franchise, etc., do not enter, although those very items form "a very essential part of the *shareholders'* capital stock." (See the same view in *People vs. Sohmer*, 179 A. D., 721, aff'd 222 N. Y., 545.) That property rather than excise taxes are considered in any given case is not material, if the search is for definitions; except as any definition is apt to be influenced by environment; and the definition of Finch, J. in the Coleman case was approvingly quoted in *Home etc. Bank vs Des Moines*, 205 U. S., 503.

**3188** This New York concept has perhaps been applied in this Court, under a statute (30 Stat., 448) laying a privilege tax "computed on the basis of the capital and surplus of the preceding fiscal year." (*Leather, etc. Bank vs. Treat*, 128 Fed., 262; *Central etc. Co. vs. Treat*, 171 Fed., 301.) And again under an act (38 Stat. 745 (755) laying an excise to be computed on the basis of the "capital, surplus and undivided profits," etc. (*Anderson vs. Farmers' etc. Co.*, 241 Fed., 322.) But in all these cases the statutory language was far more definite than in the present instance.

**3189** Minnesota, however, has said that capital stock may mean "all the corporate possessions and possibilities; (it) represents its business opportunities and capacities as well as its tangible assets" (*Slater vs. Duluth etc. Co.*, 76 Minn., 96 (103).)

**3190** Illinois thus attempts definition: "Capital stock means \* \* \* the beneficial ownership of everything that enters into the property of the corporation, (including in the case of a railroad) the opportunities, inherent in the corporation and its franchise, of creating earnings." (*Chicago etc. Co. vs State Board*, 112 Fed., 607; and of *Pacific etc. Co. vs. Lieb*, 83 Ill., 602; *State Board vs. People*, 191 Ill., 528). In other words—within wide limits, capital stock means what the legislature wants it to mean.

**3191** In Kentucky, the Supreme Court of the United States, found that the legislature meant by capital stock "the entire property real and personal, tangible and intangible, all assets on hand and (the Company's) franchise as well," and expressed no objection to this concept of the phrase. (*Henderson etc. Co. vs. Commonwealth*, 166 U. S., 150; affirming 99 Ky., 623.) That is to say, each state can define for itself; and the right of definition is primarily in the legislature.

**3192** In Ohio also the Supreme Court found without objection that the state scheme regarded "capital stock" as representing "not only the tangible property, but also the intangible, including therein all corporate franchises and all contracts, privileges and good will of the concern." (*Adams etc. Co. vs. Ohio*, 166 U. S., 185).

**3193** Wisconsin has perhaps stated the possibilities of the phrase most conveniently for the legislator, by declaring that "capital stock" may apply to one or another of three mental concepts, (1) the stockholders' shares, (2) the corporate property, (3) a mere measure of size of corporation as a test for graduating taxes (*First National Bank vs. Douglas County*, 124 Wis., 15). The lack of fixity of meaning, the absence of any agreement in definition shown by the foregoing examples (which might be much extended) constrain to the belief that "capital stock" is a term plastic to say the least, and compelling its interpreter to look first to the context for a meaning that has not been reduced to any rigid formula.

**3194** We do not think that making the basis of computation "The fair value" of capital stock advances the matter; and we are sure that whether one speaks of a tax on property or a tax measured by property, such

## CAPITAL STOCK TAX REGULATIONS.

variation in tax kind works *per se* no change in the meaning of the words "capital stock." "Fair" value does not import guesswork, and unless incompetence or worse be imputed to the assessor, the phrase is the exact equivalent of the "actual value" of the Coleman case.

**3195** But when the statute speaks of "estimating" capital stock, and of arriving at the "fair average value" thereof for a year—the words are so inappropriate to the process of transcribing book values, that an inference is irresistible of some other process being within the legislative intent.

**3196** When one considers further that corporate excise taxes are not new with this act of Congress—observes that this form of words is a marked departure from previous acts (*e. g.* 38 Stat., 745 *supra*), and remembers that Congress acted in the absence of any rigid legal or judicial definition of "capital stock," the interpreter is compelled to have recourse to the annals of congressional action to find out what the legislature meant and thought it said.

**3197** The remarks made by the "Committee Chairman in charge" of the bill (*United States vs. St. Paul etc. R'y*, 247 U. S., 310 (318)) are available in Cong. Rec., 64th Cong., 1st Sess., Sept. 7, 1916, and they satisfy us that the act was passed with the intent of permitting and indeed compelling the assessor to consider not only paid in capital, surplus and undivided profits but earnings and market value of shares. Such a method of assessment necessarily implies for the words "capital stock" an enlarged meaning, which if it does not connote the somewhat cynical view of the Wisconsin court (*supra*) certainly goes so far as to regard as "fair," an examination of "the entire potentiality of the corporation to profit by the exercise of its corporate franchise." (*First National Bank vs. Moon*, 102 Kan., 334 (343-344).)

**3198** If, as we find, the result reached by the assessor was and is consonant with such an examination and appraisalment, the judgment below [¶3170] was right.

Affirmed\* with costs.

\*Petition for writ of certiorari denied by U. S. Supreme Court, April 16, 1923.



## CAPITAL STOCK TAX REGULATIONS.

(Decision.)

1916, 1918, (and 1921) Acts.

June 1, 1923.

To tax a domestic corporation whose capital is employed in whole or in part in the export trade is not unconstitutional as imposing a tax on exports.

UNITED STATES DISTRICT COURT: SOUTHERN DISTRICT OF NEW YORK

National Paper & Type Company,  
Plaintiff,

against

William H. Edwards, Collector of Internal Revenue  
for the Second District of New York,  
Defendant.

Lord, Day &amp; Lord, Attorneys for Plaintiff.

William Hayward, U. S. Attorney, for the defendant. Richard S. Holmes,  
Special Assistant U. S. Attorney and Chester A. Bennett, Special  
Attorney.

**3199** MACK, Circuit Judge:—This is a suit to recover taxes paid under  
3001 protest. The amended complaint sets forth two alleged causes of  
3015 action. The first relates to a payment of \$487.50 alleged to have  
been exacted under §407 of Title IV of the Act of Congress approved  
September 8, 1916; and the second relates to a payment of \$581.50 alleged  
to have been exacted under §1000 of Title X of the Revenue Act of 1918.  
The pertinent provisions of the Acts in question are set forth in the margin.  
[So far as here material the 1916, 1918, and 1921 (§3000) Acts are similar.]\*  
It is contended that the capital stock tax imposed by these Acts is unconstitutional  
as applied to the plaintiff corporation, the business of which is confined  
to the exportation of goods from the United States to foreign countries and  
the sale of goods to export commission merchants in this country, with the  
intent and purpose that the same should be exported, and with the result that  
such goods are in fact exported. It is alleged that the tax as applied to the  
plaintiff corporation is a tax on exports prohibited by Article I, §9, Clause 5  
of the Constitution. The defendant moves for judgment on the pleadings  
on the ground that the facts alleged are not sufficient to constitute a cause  
of action.

**3200** The tax in question is in form an excise tax on the privilege of doing  
business as a corporation measured by the fair average value of the  
capital stock of the corporation for the preceding year. *Washington Water  
Power Co. v. United States*, 56 Ct. Cl. 76 [¶3105]; *Flint v. Stone Tracy Co.*,  
220 U. S. 107.

\*The Government contends that the first as well as the second tax was levied under §1000 of the Revenue Act of 1918. But since no question is raised as to the amount of the tax, it is immaterial for the purposes of the present suit whether the tax was imposed under the Revenue Act of 1916 or 1918.

**3201** In *Peck & Co. v. Lowe*, 247 U. S. 165, the Supreme Court, in sustaining a federal tax on the net income of a domestic corporation derived from the business of shipping goods to foreign countries and there selling them, thus summarizes its previous decisions:

"The Constitution broadly empowers Congress not only 'to lay and collect taxes, duties, imposts and excises,' but also 'to regulate commerce with foreign nations.' So, if the prohibitory clause invoked by the plaintiff be not in the way, Congress undoubtedly has power to lay and collect such a tax as is here in question. That clause says, 'No tax or duty shall be laid on articles exported from any State.' Of course it qualifies and restricts the power to tax as broadly conferred. But to what extent? The decisions of this court answer that it excepts from the range of that power articles in course of exportation, *Turpin v. Burgess*, 117 U. S. 504, 507; the act or occupation of exporting, *Brown v. Maryland*, 12 Wheat, 419, 445; bills of lading for articles being exported, *Fairbank v. United States*, 181 U. S. 283; charter parties for the carriage of cargoes from state to foreign ports, *United States v. Hvoslef*, 237 U. S. 1; and policies of marine insurance on articles being exported,—such insurance being uniformly regarded as 'an integral part of the exportation' and the policy as 'one of the ordinary shipping documents,' *Thames and Mersey Insurance Co. v. United States*, 237 U. S. 19. In short, the court has interpreted the clause as meaning that exportation must be free from taxation, and therefore as requiring 'not simply an omission of a tax upon the articles exported, but also a freedom from any tax which directly burdens the exportation.' *Fairbank v. United States*, supra, pp. 292-293. And the court has indicated that where the tax is not laid on the articles themselves while in course of exportation the true test of its validity is whether it 'so directly and closely' bears on the 'process of exporting' as to be in substance a tax on the exportation. *Thames and Mersey Insurance Co. v. United States*, supra, p. 25. In this view it has been held that the clause does not condemn or invalidate charges or taxes, not laid on property while being exported, merely because they affect exportation indirectly or remotely. Thus a charge for stamps which each package of manufactured tobacco intended for export was required to bear before removal from the factory was upheld in *Pace v. Burgess*, 92 U. S. 372; and *Turpin v. Burgess*, 117 U. S. 504; and the application of a manufacturing tax on all filled cheese to cheese manufactured under contract for export, and actually exported, was upheld in *Cornell v. Coyne*, 192 U. S. 418. In that case it was said, p. 427: 'The true construction of the constitutional provision is that no burden by way of tax or duty can be cast upon the exportation of articles, and does not mean that articles exported are relieved from the prior ordinary burdens of taxation which rest upon all property similarly situated. The exemption attaches to the export and not to the article before its exportation.'

**3202** The Supreme Court then added that the income tax there in question was not laid on articles in the course of transportation or anything which inherently or by usage is embraced in transportation, or any of its processes. It was a tax laid generally on net income. While it could not be applied to any income which Congress had no power to tax, it was both nominally and actually a general tax. It was not laid on income from exportation because of its source, or in a discriminatory way, but just as it



was laid on other income; exportation was affected only indirectly and remotely. If articles manufactured and intended for export were subject to taxation under general laws up to the time they were put in the course of exportation, the conclusion was unavoidable that the net income from the venture when completed was likewise subject to taxation under general laws.

**3203** In a companion case, *United States Glue Co. v. Oak Creek*, 247 U. S. 321, wherein the power of a state under a general income law to include income derived from transactions in interstate commerce, was sustained. The Supreme Court stated:

"It is settled that a State may not directly burden interstate commerce, either by taxation or otherwise. But a tax that only indirectly affects the profits or returns from such commerce is not within the rule. Thus, it was declared in *Postal Telegraph Cable Co. v. Adams*, 155 U. S. 688, 695-696: 'It is settled that where by way of duties laid on the transportation of the subjects of interstate commerce, or on the receipts derived therefrom or on the occupation or business of carrying it on, a tax is levied by a State on interstate commerce, such taxation amounts to a regulation of such commerce and cannot be sustained. But property in a State belonging to a corporation, whether foreign or domestic, engaged in foreign or interstate commerce, may be taxed, or a tax may be imposed on the corporation on account of its property within a State, and may take the form of a tax for the privilege of exercising its franchises within the State, if the ascertainment of the amount is made dependent in fact on the value of its property situated within the State, (the exaction, therefore, not being susceptible of exceeding the sum which might be leviable directly thereon), and if payment be not made a condition precedent to the right to carry on the business, but its enforcement left to the ordinary means devised for the collection of taxes.' Again, in *Atlantic & Pacific Telegraph Co. v. Philadelphia*, 190 U. S. 160, 163, the court upon a review of numerous previous cases laid down certain propositions as established, among them these: (a) that the immunity of an individual or corporation engaged in interstate commerce from state regulation does not prevent a State from imposing ordinary property taxes upon property having a situs within its territory and employed in interstate commerce; and (b) that the franchise of a corporation, although that franchise be the business of interstate commerce, is, as a part of its property, subject to state taxation, provided at least the franchise be not derived from the United States. See also, *St. Louis Southwestern Ry. Co. v. Arkansas*, 235 U. S. 350, 365.

"Yet it is obvious that taxes imposed upon property or franchises employed in interstate commerce must be paid from the net returns of such commerce, and diminish them in the same sense that they are diminished by a tax imposed upon the net returns themselves.

"The distinction between direct and indirect burdens, with particular reference to a comparison between a tax upon the gross returns of carriers in interstate commerce and a general income tax imposed upon all inhabitants incidentally affecting carriers engaged in such commerce, was the subject of consideration in *Philadelphia & Southern S. S. Co. v. Pennsylvania*, 122 U. S. 326, 345, where the court, by Mr. Justice Bradley, said: 'The corporate franchises, the property, the business, the income of corporations created by a State may undoubtedly be taxed by the State; but in imposing such taxes care should be taken not to inter-

fere with or hamper, directly or by indirection, interstate or foreign commerce, or any other matter exclusively within the jurisdiction of the Federal government'."\*

**3204** Under the principles above enunciated by the Supreme Court it would seem clear that the Federal Government may levy a general excise tax on the privilege of doing business in corporate form measured by the fair value of the capital stock and that the tax is not invalid in so far as, or because the property or capital is employed in the export trade.

**3205** The plaintiff relies strongly upon the analogy afforded by cases like *Western Union Telegraph Co. v. Kansas*, 216 U. S. 1, *International Paper Co. v. Massachusetts*, 246 U. S. 135, wherein it was held that an excise tax levied by a state on the privilege of doing business within the state, measured by the entire capital of the corporation within and without the state, was under the circumstances of the particular case invalid because the purpose or necessary effect of the Act was to burden interstate commerce or tax property beyond the jurisdiction of the State. c. f. *Baltic Mining Co. v. Massachusetts*, 231 U. S. 68; *Kansas City, etc. R. R. Co. v. Botkin*, 240 U. S. 226; *Kansas City, etc. R. R. Co. v. Stiles*, 242 U. S. 111.

**3206** To this contention it may be answered that not only is the power of the Federal Government with reference to foreign commerce not as limited as is the power of a State with reference to interstate commerce, but under the decisions, a State may, in non-discriminatory manner, tax property, tangible or intangible, employed in interstate commerce, so long as it does not reach out for more than its fair share. A State may thus tax that proportion of the entire capital of a corporation that its property or business in the State bears to all its property and business. *St. Louis S. W. R. Co. v. Arkansas*, 235 U. S. 350; *New York v. Roberts*, 171 U. S. 658; *Adams Express Co. v. Ohio State Auditor*, 165 U. S. 194; *Western Union v. Taggart*, 163 U. S. 1; *Postal Co. v. Adams*, 155 U. S. 688; *Pittsburgh C. C. & St. L. R. Co. v. Backus*, 254 U. S. 429. Such analogy, therefore, as these cases afford would seem to support the power of the Federal Government to levy a general excise tax on the privilege of doing business in corporate form measured by the fair value of the capital stock, without any exemption to any corporation by reason of its capital being employed in whole or in part in the export trade.

**3207** The defendant's motion for judgment on the pleadings will be granted.

\*A state, however, may not levy a direct tax on the gross receipts from interstate commerce, even though the tax is general, and applies as well to the internal commerce of the State. *Crew Levick Co. v. Pennsylvania*, 245 U. S. 295; nor may the United States levy such a tax on export sales or the gross receipts therefrom; the tax is not being by reason of the fact that it may be equally applicable to domestic commerce. *A. G. Spaulding & Bros. v. Edwards, Collector*, decided by the Supreme Court on April 23, 1923 [¶4767 herein].



## CAPITAL STOCK TAX REGULATIONS.

(Decision.)

1916 and 1918 Acts.

November 14, 1923.

A corporation whose activities consist of holding the stock of another, with the incidents thereof, and of financing such other, and, because such other's financial requirements were overestimated, investing large amounts in call loans, thereby exercising its full corporate powers, is held not to be engaged in business within the purview of the taxing statute.

UNITED STATES DISTRICT COURT, SOUTHERN DISTRICT OF NEW YORK.

CHILE COPPER COMPANY,

Plaintiff,

vs.

WILLIAM H. EDWARDS, Collector of Internal Revenue,  
Second New York District,

Defendant.

**3208** Learned Hand, D. J.: It is quite true that this plaintiff has been  
 3031 doing all that it was organized to do, and that this feature constantly  
 3033 runs through the cases, as if it were in some sense a test of whether  
 it was "doing business" at all. Yet I cannot think that this would  
 be a sound rule, or that it makes any difference whether the chartered powers  
 are fully employed or not, because as Mr. Justice Holmes said in *U. S. v.*  
*Emery-Bird, Thayer Realty Co.*, 237 U. S. 28, the question is what it does  
 and not what it can do. There would be no justification in treating two  
 corporations differently who did exactly the same things merely because  
 one had an extensive charter and the other did not.

**3209** Had this been a lease I think there could be no doubt. The differ-  
 ent incidents of the plaintiff's activity have all been passed on.  
 Thus receiving and distributing dividends is not enough to bring the lessor  
 within the Statute, *Zonne v. Minneapolis Syndicate*, 220 U. S. 187, *McCoach*  
*v. Minehill Ry.*, 228 U. S. 295; *U. S. v. Nipissing Mines Co.*, 206 U. S. Fed.  
 Rep. 431 (C.C.A. 2); *West End Ry. v. Malley*, 246 Fed. Rep. 625 (C.C.A.  
 1). Nor is the result different if the lessor in addition issues bonds direct to  
 the lessee for his use in paying for improvements upon the leased lands,  
*Anderson v. Morris & Essex R.R.*, 216 Fed. Rep. 83 (C.C.A. 2), *N. Y. Cen-*  
*tral v. Gill*, 219 Fed. Rep. (C.C.A. 1), *Traction Cos. v. Collectors*, 223 Fed.  
 Rep. 984 (C.C.A. 6), *Public Service Co. v. Herold*, 229 Fed. Rep. 902 (C.C.A.  
 3). In one of the cases comprised within *Public Service Co. v. Herold*, *supra*,  
 it was held that when the lessor, instead of delivering bonds to the lessee,  
 to be sold, sold the bonds himself and paid the money to the lessee the  
 result was the same. The following cases present variants upon the general  
 situation in each of which the lessor was held not to be "doing business":  
 condemning lands for the lessee, *N. Y. Central v. Gill*, *supra*; selling parts  
 of the leased property, *Traction Cos. v. Collectors*, *supra*; selling the whole  
 property, *Miller v. Snake River Valley R.R.*, 223 Fed. Rep. 946; providing  
 for the issue of new bonds to refund others cancelled, *Public Service Co. v.*  
*Herold*, *supra*; maintaining a sinking fund and extending an indebtedness,

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## CAPITAL STOCK TAX REGULATIONS.

McCoach v. Continental, etc., Co., 233 Fed. Rep. 976; acquiring new property for the lessee and improving it to answer to the lease, Jasper, etc., Co. v. Walker, 238 Fed. Rep. 533 (C.C.A. 5), (certainly an extreme case); investing the lessor's surplus funds in investments more profitable than bank deposits, McCoach v. Minehill Ry. Co., 228 U. S. 295.

**3210** Had the plaintiff leased its property to the Exploration Co. and thereafter done what it did there can then be no doubt that it would not have been liable to the tax. It seems to me to make no difference that it was organized to do the same things. The term, "business," means some profitable activity undertaken on its own account. There was such a business, but it was the mining and sale of copper, to which both corporations were necessary, owing to the state of the Chilean law. Of course, it is true that each was doing a part of that business, because financing was a necessary incident to its prosecution. But the excise does not exact a double tax for leave to do a single business, and the plaintiff was in substance no more than the personification of a part of the enterprise. Except for the separation of the corporate activities no one would suggest that the Exploration Company was doing two businesses. As things are, the nearest approach to a separate business is the plaintiff's investment of its funds in call loans. That, however, falls quite within the rule in McCoach v. Minehill Ry. Co., supra.

**3211** The defendant argues that Van Baumbach v. Sargent Land Co., 242 U. S. 503, changed the earlier rule and made obsolete the decisions in the lower courts which have depended upon it. I cannot so understand that decision. The lessor by no means confined itself to activities incidental to the execution of the lease and it was to those added doings that it owed its liability to the tax. It is true that among these was the employment of a supervising engineer (a company), and that this is one of the activities relied upon. While this was a natural incident to the protection of the lessor's interests, yet it was no part of the execution of the lease, no part of the business conducted by the lessee. However that may be, the lessor did much more than that. It explored the soil on its own account, sold land, made stumpage contracts and leased lots in a village and to squatters. In short, it appears to have managed the surface for its profit. All this was altogether independent of the business of the lessee.

**3212** Chemung Iron Co. v. Lynch, 269 Fed. Rep. 368 (C.C.A. 8), was a similar case though the lessor merely hired a supervising engineer and explored the soil. In Boston Terminal Co. v. Gill, 246 Fed. Rep. 604 (C.C.A. 1), the plaintiff conducted a number of profitable ventures in its railway station, quite separate from its formal maintenance of that station for the benefit of the five roads which built it.

**3213** I see no ground in these cases to suppose that the earlier decisions are no longer controlling, and for the reasons already given I think that the motion to dismiss must be denied. That being so, it is my understanding that the plaintiff is to take judgment for the amount demanded with interest, and it is so ordered.

**3214** Central Union Trust Company vs. Edwards.—This cause is now in 3171 the United States Supreme Court on writ of error, Docket No. 317, 3198 October Term, 1923.—The Corporation Trust Company.



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# STAMP TAXES—1921 ACT

BEING TITLE XI OF THE REVENUE ACT OF 1921.

## TITLE XI.—STAMP TAXES.

**3500** Sec. 1100. That on and after January 1, 1922, there shall be levied, collected, and paid, for and in respect of the several bonds, debentures, or certificates of stock and of indebtedness, and other documents, instruments, matters, and things mentioned and described in Schedule A of this title, or for or in respect of the vellum, parchment, or paper upon which such instruments, matters, or things, or any of them, are written or printed, by any person who makes, signs, issues, sells, removes, consigns, or ships the same, or for whose use or benefit the same are made, signed, issued, sold, removed, consigned, or shipped, the several taxes specified in such schedule. The taxes imposed by this section shall, in the case of any article upon which a corresponding stamp tax is now imposed by law, be in lieu of such tax.

[United States, State, Municipal, and Foreign Government  
Bonds, and other Instruments Exempt.]

**3501** Sec. 1101. That there shall not be taxed under this title any bond, note, or other instrument, issued by the United States, or by any foreign Government, or by any State, Territory, or the District of Columbia, or local subdivision thereof, or municipal or other corporation exercising the taxing power; or any bond of indemnity required to be filed by any person to secure payment of any pension, allowance, allotment, relief, or insurance by the United States, or to secure a duplicate for, or the payment of, any bond, note, certificate of indebtedness, war-savings certificate, warrant or check, issued by the United States; or stocks and bonds issued by cooperative building and loan associations which are organized and operated exclusively for the benefit of their members and make loans only to their shareholders, or by mutual ditch or irrigation companies.

[Penalty for Failure to Pay Tax and for Failure to Cancel Stamps.]

**3502** Sec. 1102. That whoever—

**3503** (a) Makes, signs, issues, or accepts, or causes to be made, signed, issued, or accepted, any instrument, document, or paper of any kind or description whatsoever without the full amount of tax thereon being duly paid;

**3504** (b) Manufactures or imports and sells, or offers for sale, or causes to be manufactured or imported and sold, or offered for sale, any playing cards, package, or other article without the full amount of tax being duly paid;

**3505** (c) Makes use of any adhesive stamp to denote any tax imposed by this title without canceling or obliterating such stamp as prescribed in section 1104;

**3506** Is guilty of a misdemeanor and upon conviction thereof shall pay a fine of not more than \$100 for each offense.

## [Penalty for Fraud in Connection with Stamps.]

**3507** Sec. 1103. That whoever

**3508** (a) Fraudulently cuts, tears, or removes from any vellum, parchment, paper, instrument, writing, package, or article, upon which any tax is imposed by this title, any adhesive stamp or the impression of any stamp, die, plate, or other article provided, made, or used in pursuance of this title;

**3509** (b) Fraudulently uses, joins, fixes, or places to, with, or upon any vellum, parchment, paper, instrument, writing, package, or article, upon which any tax is imposed by this title, (1) any adhesive stamp, or the impression of any stamp, die, plate, or other article, which has been cut, torn, or removed from any other vellum, parchment, paper, instrument, writing, package, or article, upon which any tax is imposed by this title; or (2) any adhesive stamp or the impression of any stamp, die, plate, or other article of insufficient value; or (3) any forged or counterfeited stamp, or the impression of any forged or counterfeited stamp, die, plate, or other article;

**3510** (c) Willfully removes, or alters the cancellation, or defacing marks of, or otherwise prepares, any adhesive stamp, with intent to use, or cause the same to be used, after it has been already used, or knowingly or willfully buys, sells, offers for sale, or gives away, any such washed or restored stamp to any person for use, or knowingly uses the same;

**3511** (d) Knowingly and without lawful excuse (the burden of proof of such excuse being on the accused) has in possession any washed, restored, or altered stamp, which has been removed from any vellum, parchment, paper, instrument, writing, package, or article;

**3512** Is guilty of a misdemeanor, and upon conviction shall be punished by a fine of not more than \$1,000, or by imprisonment for not more than five years, or both, and any such reused, canceled, or counterfeit stamp and the vellum, parchment, document, paper, package, or article upon which it is placed or impressed shall be forfeited to the United States.

## [Cancellation of Stamps.]

**3513** Sec. 1104. That whenever an adhesive stamp is used for denoting any tax imposed by this title, except as hereinafter provided, the person using or affixing the same shall write or stamp or cause to be written or stamped thereupon the initials of his or its name and the date upon which the same is attached or used, so that the same may not again be used: *Provided*, That the Commissioner may prescribe such other method for the cancellation of such stamps as he may deem expedient.

## [Preparation, Distribution and Affixing of Stamps.]

**3514** Sec. 1105. (a) That the Commissioner shall cause to be prepared and distributed for the payment of the taxes prescribed in this title suitable stamps denoting the tax on the document, articles, or thing to which the same may be affixed, and shall prescribe such method for the affixing of said stamps in substitution for or in addition to the method provided in this title, as he may deem expedient.



**3515** (b) All internal revenue laws relating to the assessment and collection of taxes are hereby extended to and made a part of this title, so far as applicable, for the purpose of collecting stamp taxes omitted through mistake or fraud from any instrument, document, paper, writing, parcel, package, or article named herein.

[Stamps to be on Sale at Post-Offices.]

**3516 Sec. 1106.** That the Commissioner shall furnish to the Postmaster General without prepayment a suitable quantity of adhesive stamps to be distributed to and kept on sale by the various postmasters in the United States. The Postmaster General may require each such postmaster to give additional or increased bond as postmaster for the value of the stamps so furnished, and each such postmaster shall deposit the receipts from the sale of such stamps to the credit of and render accounts to the Postmaster General at such times and in such form as he may by regulations prescribe. The Postmaster General shall at least once monthly transfer all collections from this source to the Treasury as internal-revenue collections.

[Stamps to be on Sale at Designated Depositories.]

**3517 Sec. 1107.** (a) That each collector shall furnish, without prepayment, to any assistant treasurer or designated depository of the United States, located in the district of such collector, a suitable quantity of adhesive stamps to be kept on sale by such assistant treasurer or designated depository.

**3518** (b) Each collector shall furnish, without prepayment, to any person who is (1) located in the district of such collector, (2) duly appointed and acting as agent of any State for the sale of stock transfer stamps of such State, and (3) designated by the Commissioner for the purpose, a suitable quantity of such adhesive stamps as are required by subdivisions 2, 3, and 4 of Schedule A of this title, to be kept on sale by such person.

**3519** (c) In such cases the collector may require a bond, with sufficient sureties, in a sum to be fixed by the Commissioner, conditioned for the faithful return, whenever so required, of all quantities or amounts undisposed of, and for the payment monthly of all quantities or amounts sold or not remaining on hand. The Secretary may from time to time make such regulations as he may find necessary to insure the safekeeping or prevent the illegal use of all such adhesive stamps.

SCHEDULE A.—STAMP TAXES.

[Bonds of Indebtedness.]

**3520** 1. Bonds of indebtedness: On all bonds, debentures, or certificates of indebtedness issued by any person, and all instruments, however termed, issued by any corporation with interest coupons or in registered form, known generally as corporate securities, on each \$100 of face value or fraction thereof, 5 cents: *Provided*, That every renewal of the foregoing shall be taxed as a new issue: *Provided further*, That when a bond conditioned for the repayment or payment of money is given in a penal sum greater than the debt secured, the tax shall be based upon the amount secured.

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**[Original Issue of Stock.]**

**3521** 2. Capital stock, issued: On each original issue, whether on organization or reorganization, of certificates of stock, or of profits, or of interest in property or accumulations, by any corporation, on each \$100 of face value or fraction thereof, 5 cents: *Provided*, That where a certificate is issued without face value, the tax shall be 5 cents per share, unless the actual value is in excess of \$100 per share, in which case the tax shall be 5 cents on each \$100 of actual value or fraction thereof, or unless the actual value is less than \$100 per share, in which case the tax shall be 1 cent on each \$20 of actual value, or fraction thereof.

**3522** The stamps representing the tax imposed by this subdivision shall be attached to the stock books and not to the certificates issued.

**[Sales or Transfers of Stocks.]**

**3523** 3. Capital stock, sales or transfers: On all sales, or agreements to sell, or memoranda of sales or deliveries of, or transfers of legal title to shares or certificates of stock or of profits or of interest in property or accumulations in any corporation, or to rights to subscribe for or to receive such shares or certificates, whether made upon or shown by the books of the corporation, or by any assignment in blank, or by any delivery, or by any paper or agreement or memorandum or other evidence of transfer or sale, whether entitling the holder in any manner to the benefit of such stock, interest, or rights, or not, on each \$100 of face value or fraction thereof, 2 cents, and where such shares are without par or face value, the tax shall be 2 cents on the transfer or sale or agreement to sell on each share:

**3524** *Provided*, That it is not intended by this title to impose a tax upon an agreement evidencing a deposit of certificates as collateral security for money loaned thereon, which certificates are not actually sold, nor upon the delivery or transfer for such purpose of certificates so deposited, nor upon mere loans of stock nor upon the return of stock so loaned:

**3525** *Provided further*, That the tax shall not be imposed upon deliveries or transfers to a broker for sale, nor upon deliveries or transfers by a broker to a customer for whom and upon whose order he has purchased same, but such deliveries or transfers shall be accompanied by a certificate setting forth the facts:

**3526** *Provided further*, That in case of sale where the evidence of transfer is shown only by the books of the corporation the stamp shall be placed upon such books; and where the change of ownership is by transfer of the certificate the stamp shall be placed upon the certificate; and in cases of an agreement to sell or where the transfer is by delivery of the certificate assigned in blank there shall be made and delivered by the seller to the buyer a bill or memorandum of such sale, to which the stamp shall be affixed; and every bill or memorandum of sale or agreement to sell before mentioned shall show the date thereof, the name of the seller, the amount of the sale, and the matter or thing to which it refers.



**3527** Any person liable to pay the tax as herein provided, or anyone who acts in the matter as agent or broker for such person, who makes any such sale, or who in pursuance of any such sale delivers any certificate or evidence of the sale of any stock, interest or right, or bill or memorandum thereof, as herein required, without having the proper stamps affixed thereto with intent to evade the foregoing provisions, shall be deemed guilty of a misdemeanor, and upon conviction thereof shall pay a fine of not exceeding \$1,000, or be imprisoned not more than six months, or both.

**[Sales of Produce at or Under the Rules of Exchanges.]**

**3528** 4. Produce, sales of, on exchange: Upon each sale, agreement of sale, or agreement to sell (not including so-called transferred or scratch sales), any products or merchandise at, or under the rules or usages of, any exchange, or board of trade, or other similar place, for future delivery, for each \$100 in value of the merchandise covered by said sale or agreement of sale or agreement to sell, 2 cents, and for each additional \$100 or fractional part thereof in excess of \$100, 2 cents:

**3529** *Provided*, That on every sale or agreement of sale or agreement to sell as aforesaid there shall be made and delivered by the seller to the buyer a bill, memorandum, agreement, or other evidence of such sale, agreement of sale, or agreement to sell, to which there shall be affixed a lawful stamp or stamps in value equal to the amount of the tax on such sale:

**3530** *Provided further*, That sellers of commodities described herein, having paid the tax provided by this subdivision, may transfer such contracts to a clearing-house corporation or association, and such transfer shall not be deemed to be a sale, or agreement of sale, or an agreement to sell within the provisions of this Act, provided that such transfer shall not vest any beneficial interest in such clearing-house association but shall be made for the sole purpose of enabling such clearing-house association to adjust and balance the accounts of the members of such clearing-house association on their several contracts.

**3531** Every such bill, memorandum, or other evidence of sale or agreement to sell shall show the date thereof, the name of the seller, the amount of the sale, and the matter or thing to which it refers; and any person liable to pay the tax as herein provided, or anyone who acts in the matter as agent or broker for such person, who makes any such sale or agreement of sale, or agreement to sell, or who, in pursuance of any such sale, agreement of sale, or agreement to sell, delivers any such products or merchandise without a bill, memorandum, or other evidence thereof as herein required, or who delivers such bill, memorandum, or other evidence of sale, or agreement to sell, without having the proper stamps affixed thereto, with intent to evade the foregoing provisions, shall be deemed guilty of a misdemeanor, and upon conviction thereof shall pay a fine of not exceeding \$1,000 or be imprisoned not more than six months, or both.

**3532** No bill, memorandum, agreement, or other evidence of such sale, or agreement of sale, or agreement to sell, in case of cash sales of products or merchandise for immediate or prompt delivery which in good faith are actually intended to be delivered shall be subject to this tax.

**3533** This subdivision shall not affect but shall be in addition to the provisions of the "United States Cotton Futures Act," approved August 11, 1916, as amended, and "The Future Trading Act," approved August 24, 1921.

**[Promissory Notes and Drafts or Checks Other than Sight or Demand.]**

**3534** 5. Drafts or checks (payable otherwise than at sight or on demand) upon their acceptance or delivery within the United States whichever is prior, promissory notes, except bank notes issued for circulation, and for each renewal of the same, for a sum not exceeding \$100, 2 cents; and for each additional \$100, or fractional part thereof, 2 cents.

**3535** This subdivision shall not apply to a promissory note secured by the pledge of bonds or obligations of the United States issued after April 24, 1917, or secured by the pledge of a promissory note which itself is secured by the pledge of such bonds or obligations: *Provided*, That in either case the par value of such bonds or obligations shall be not less than the amount of such note.

**[Conveyances.]**

**3536** 6. Conveyances: Deed, instrument, or writing, whereby any lands, tenements, or other realty sold shall be granted, assigned, transferred, or otherwise conveyed to, or vested in, the purchaser or purchasers, or any other person or persons, by his, her, or their direction, when the consideration or value of the interest or property conveyed, exclusive of the value of any lien or encumbrance remaining thereon at the time of sale, exceeds \$100 and does not exceed \$500, 50 cents; and for each additional \$500 or fractional part thereof, 50 cents. This subdivision shall not apply to any instrument or writing given to secure a debt.

**[Customhouse Entries.]**

**3537** 7. Entry of any goods, wares, or merchandise at any customhouse, either for consumption or warehousing, not exceeding \$100 in value, 25 cents; exceeding \$100 and not exceeding \$500 in value, 50 cents; exceeding \$500 in value, \$1.

**[Customs Bonded Warehouse Withdrawal Entries.]**

**3538** 8. Entry for the withdrawal of any goods or merchandise from customs bonded warehouse, 50 cents.

**[Passage Tickets for Foreign Ports Other than Those in Canada or Mexico.]**

**3539** 9. Passage ticket, one way or round trip, for each passenger, sold or issued in the United States for passage by any vessel to a port or place not in the United States, Canada, or Mexico, if costing not exceeding \$30, \$1; costing more than \$30 and not exceeding \$60, \$3; costing more than \$60, \$5. This subdivision shall not apply to passage tickets costing \$10 or less.



## [Proxies.]

**3540** 10. Proxy for voting at any election for officers, or meeting for the transaction of business, of any corporation, except religious, educational, charitable, fraternal, or literary societies, or public cemeteries, 10 cents.

## [Powers of Attorney.]

**3541** 11. Power of attorney granting authority to do or perform some act for or in behalf of the grantor, which authority is not otherwise vested in the grantee, 25 cents. This subdivision shall not apply to any papers necessary to be used for the collection of claims from the United States or from any State for pensions, back pay, bounty, or for property lost in the military or naval service, nor to powers of attorney required in bankruptcy cases nor to powers of attorney contained in the application of those who become members of or policy holders in mutual insurance companies doing business on the inter-insurance or reciprocal indemnity plan through an attorney in fact.

## [Playing Cards.]

**3542** 12. Playing cards: Upon every pack of playing cards containing not more than fifty-four cards, manufactured or imported, and sold, or removed for consumption or sale, a tax of 8 cents per pack.

## [Casualty Insurance Policies Written by Certain Foreign Corporations or Partnerships or Nonresident Aliens.]

**3543** 13. On each policy of insurance, or certificate, binder, covering note, memorandum, cablegram, letter, or other instrument by whatever name called whereby insurance is made or renewed upon property within the United States (including rents and profits) against peril by sea or on inland waters or in transit on land (including transshipments and storage at termini or way points) or by fire, lightning, tornado, wind-storm, bombardment, invasion, insurrection or riot, issued to or for or in the name of a domestic corporation or partnership or an individual resident of the United States by any foreign corporation or partnership or any individual not a resident of the United States, when such policy or other instrument is not signed or countersigned by an officer or agent of the insurer in a State, Territory, or District of the United States within which such insurer is authorized to do business, a tax of 3 cents on each dollar, or fractional part thereof of the premium charged:

**3544** *Provided*, That policies of reinsurance shall be exempt from the tax imposed by this subdivision.

**3545** Any person to or for whom or in whose name any such policy or other instrument is issued, or any solicitor or broker acting for or on behalf of such person in the procurement of any such policy or other instrument, shall affix the proper stamps to such policy or other instrument, and for failure to affix such stamps with intent to evade the tax shall, in addition to other penalties provided therefor, pay a fine of double the amount of the tax.

## [General Administrative Provisions of Law.]

[Read under "Miscellaneous" at the back of the book.]

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## I.

**REGULATIONS 40\***

Relating to

**Original Issue and Transfer of Stock**

and

**Sales of Products for Future Delivery**

[See complete Table of Contents beginning on page 709 opposite.]

## II.

**REGULATIONS 55\***

Relating to

Documents

(Other than items covered by I above)

[Beginning on page 737. Fully indexed at the back of this "Stamp Taxes" division.]

**\*Supplementary and new matters.**—Forward references are given in place within the formal Regulations to all supplementary rulings contained in the Stamp Taxes division of the Service to date of original issue (January 1, 1923). See page 762. For matters issued since January 1, 1923 see yellow Stamp Taxes Supplementary Page 2 which faces the blue Stamp Tax index.



## STAMP TAX REGULATIONS.

3546

## REGULATIONS 40—1922 EDITION

[Promulgated July 8, 1922—Also designated as T. D. 3380.]  
(Supplemented.)

Relating to the

STAMP TAX ON ISSUES, SALES, AND TRANSFERS OF STOCK AND SALES OF  
PRODUCTS FOR FUTURE DELIVERY

Under

SUBDIVISIONS 2, 3, AND 4 OF SCHEDULE A, TITLE XI, OF THE REVENUE ACT  
OF 1921.

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## PART I.

## ISSUES OF STOCK.

<b>3547</b> Art. 1. When tax accrues.—Stock is deemed to be issued when	
<b>3521</b> it is subscribed for and the subscription is accepted by the corporation, regardless of the time of delivery of the certificate.	

**3548** Art. 2. Rate of taxation.—(a) All certificates or instruments, of whatever designation, having a par or face value, representing shares of stock, or of profits, or of interest in property or accumulations, issued by any corporation, joint-stock company or association, are subject to tax at the rate of 5 cents on each \$100 of the face value or fraction thereof.

**3549** (b) All certificates of stock, or of profits, or of interest in property or accumulations issued by any corporation, without par or face value, are subject to the tax of 5 cents per share, unless the actual value is in excess of \$100 per share, in which case the tax shall be 5 cents on each \$100 of actual value or fraction thereof, or unless the actual value is less than \$100 per share, in which case the tax shall be 1 cent on each \$20 of actual value or fraction thereof. [See ¶4016 and ¶4019].



## STAMP TAX REGULATIONS.

**3550 Art. 3. Computation of the tax.**—(a) The tax is computed upon the par or face value, if the certificates have a face value, of the certificates of stock, or of profits, or of interest in property or accumulations, of any corporation, joint-stock company or association, as set forth in the articles of incorporation, or agreement of association or of partnership, whether such par or face value appears on the face of the certificate or not.

**3551** (b) Where a certificate represents more than one share of stock (however large the number of shares), on the issue of such certificate the tax is reckoned on its par or face value and not on the par or face value of each separate share of stock which it represents.

**3552** (c) The tax on original issue is measured not by the amount paid in, on, or for the stock, but by the par or face value in the case of shares having a face value; and by the actual value in the case of shares without face value.

**3553** (d) In the case of stock without par or face value, the actual value of the stock is to be determined by the market price of each share.

**3554 Art. 4. Issues subject to tax.**—(a) The issue of certificates of stock, or of profits, or of interest in property or accumulations, by any corporation, joint-stock company or association, is subject to tax.

**3555** (b) The issue to the beneficiary of certificates covering shares in the nature of shares of stock, where a number of persons pool their individual properties and appoint trustees having a definite term of office for the purpose of managing it and retain certain rights of control over the property and a voice in the selection of the trustees who are authorized to issue the certificate, is subject to tax.

**3556** (c) The issue by a corporation of business property investment bonds, or other instruments wherein it is certified that the holder thereof is the owner of an interest in specified real property, the legal title to which has been previously conveyed to a trustee and whereby the corporation issuing the same agrees to manage the property and distribute the proceeds in a certain manner, is subject to tax.

**3557** (d) The issue by a corporation, joint-stock company or association, of stock in exchange for property, real or personal, or for the purpose of purchasing the business or assets of another concern, is subject to tax.

**3558** (e) The issue of certificates of stock by joint-stock land banks is subject to tax.

**3559** (f) The issue of stock dividend and fractional scrip certificates is subject to tax. [Read ¶3565 below.]

**3560** (g) The issue of temporary or interim certificates of stock is subject to tax.

**3561** (h) The issue of certificates of stock upon reorganization [see ¶3687] of a corporation not expressly provided for in Art. 4(l) is subject to tax as follows: Preferred stock issued in place of common, or vice versa, or one kind of preferred stock issued in place of another kind of preferred stock, or one kind of common stock issued in the place of another kind of common stock, or stock without par value issued in place of stock with par value, or vice versa, is subject to tax on the entire issue.

**3562** (i) The issue of stock by a consolidated corporation in exchange for stock of the consolidating corporations is subject to tax. [See ¶3994.]

## STAMP TAX REGULATIONS.

**3563** (j) The issue of stock, in addition to its already existing stock, by the continuing corporation in case of a merger of corporations, is subject to tax. [See ¶3994.]

**3564** (k) The issue of certificates of stock outside the United States by a domestic corporation is subject to tax.

**3564a** (l) The issue of a greater number of shares of no par value stock in lieu of a smaller issue of such shares, previously made, or the issue of a greater number of shares of par value stock in lieu of a smaller issue of such shares of the same kind, previously made, whether on organization or reorganization of the issuing corporation, is subject to stamp tax only on the additional shares so issued.

**3565** **Taxability of original issue of scrip certificates for fractional shares.—**

Please advise if the issue of scrip certificates for fractional shares of said stock having par value of one hundred dollars is subject to tax at rate of five cents for each certificate issued or at rate of five cents for each full share of the total number of shares represented by aggregate amount of scrip certificates issued. Please answer collect.

**3566** (Answer.) Stamp tax is based on par value of each certificate for fractional share issued. (Telegram of inquiry from Kennedy M. Thompson, New York, N. Y., signed by Deputy Commissioner J. M. Baker, and dated January 9, 1920.)

**3567** **Stamp tax liability on account of original issue and transfer of stock and conveyance of real property incident to the reorganization of a corporation under the laws of another State, without more.—**Reference is made to your letter of February 5, 1920, in which you inquire as to the application of stamp tax in the case where the ..... Co. of Illinois has been reorganized into the ..... [same name] Co. under the laws of the State of Ohio. [See note at ¶3573 below.]

**3568** You are advised that where a company gives up its articles of incorporation in the State of Illinois and is incorporated in the State of Ohio, the application of stamp tax is to be determined by the method followed.

**3569** In any event stamp tax on original issue applies to the stock to be issued by the new corporation.

**3570** The transfer of stock among the assets of the old corporation to the new corporation is subject to stamp tax.

**3571** Conveyance of real property from the old corporation to the new corporation in consideration of the issue of new stock to the old corporation or to its stockholders is subject to stamp tax on the basis of the value of the property.

**3572** If the new stock is issued to the old corporation the transfer of that stock from the old corporation to its stockholders is subject to stamp tax. If the new stock is issued to the stockholders of the old corporation the transfer of the right to receive that stock from the old corporation is subject to transfer stamp tax additional to the original issue stamp tax. If the old stock is surrendered to the old corporation for extinguishment no transfer stamp tax accrues. If the old stock is surrendered to the new corporation and constitutes it a corporate stockholder that surrender is taxable. (Letter to The Corporation Trust Company, signed by Commissioner Daniel C. Roper, and dated February 26, 1920.)

**3573** [Note.—The facts submitted with names omitted, on which the above ruling is based, are as follows:

The ..... Co. was organized many years ago under the laws

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## STAMP TAX REGULATIONS.

of Illinois. A new corporation of the same name has been organized under the laws of Ohio and will acquire the property and continue the business of the Illinois corporation.

**3574** The Ohio corporation will take over all the assets (both real and personal) and assume all liabilities of the Illinois corporation. In payment for the property, the Ohio corporation will deliver to the Illinois corporation certificates of stock issued in the names of the present stockholders and for the number of shares owned by them, respectively, in the Illinois corporation. The Illinois corporation will receive from its stockholders its own shares of stock, in exchange for a like number of shares of the Ohio corporation, and will then be dissolved.

**3575** The identical property will remain in the possession of the identical stockholders and the proportionate interest of each stockholder will remain unchanged, the sole purpose of the transaction being merely to domicile the present enterprise in Ohio as a matter of convenience.]

**3576** Art. 5. Issues not subject to tax.—(a) The issue of stock by co-operative building and loan associations, organized and operated exclusively for the benefit of their members and making loans only to shareholders, or by mutual ditch or irrigating companies, is not subject to tax.

**3577** (b) The issue of certificates of stock by Federal land banks is not subject to tax.

**3578** (c) The issue of "rights" to subscribe for stock by any corporation, joint-stock company or association evidenced by warrants is not subject to tax.

**3579** (d) The issue of certificates of stock in a new name, the only change in the corporation being in the name, is not subject to tax.

**3580** (e) The issue of voting trust certificates is not subject to tax.

**3581** (f) The issue, upon a merger of corporations, of certificates of stock of the same kind in substitution for the old certificates of stock is not subject to tax. [See ¶3994]

**3582** (g) The issue of certificates of stock of a smaller denomination in exchange for outstanding certificates, where there is no change in ownership or in the total amount of stock issued, is not subject to tax.

**3583** (h) The issue of the definitive certificates of stock in exchange for temporary or interim certificates upon which the tax has been paid is not subject to tax.

**3584** (i) The issue by a corporation of certificates of preferred stock in lieu of outstanding certificates of common stock, or vice versa, or the issue of certificates of preferred stock of one kind in lieu of certificates of preferred stock of another kind, pursuant to the terms of the original charter of the corporation, without other consideration and without change in the amount of the authorized capital stock of the corporation, is not subject to tax.

**3585** Art. 6. Stamp tax acts.—(a) All certificates of stock issued between December 1, 1914 and September 8, 1916, are subject to tax under the Emergency Revenue Act of October 22, 1914; those issued between December 1, 1917, and April 1, 1919, are subject to tax under the Revenue Act of 1917; and certificates of stock, or of profits, or of interest in property or accumulations issued by any corporation, joint-stock company, or association on or after April 1, 1919, are subject to tax under the Revenue Act of 1918; those issued on or after January 1, 1922, are subject to tax under the Revenue Act of 1921.

## STAMP TAX REGULATIONS.

**3586** (b) There was no stamp tax upon issues of certificates of stock  
**3587** between September 8, 1916, and December 1, 1917.

**3588** Art. 7. Documentary stamps used.—Ordinary documentary stamps shall be used in payment of the tax imposed upon the issue of stock.

**3589** Art. 8. Stamps to be attached to stock book.—The stamps representing the tax imposed by this subdivision must be attached to the stock book and not to the certificates when issued.

## PART II.—SALES AND TRANSFERS OF STOCK.

**3590** Art. 9. When tax accrues.—The stamp tax on sales or transfers  
**3523** of stock accrues at the time of making the sale or agreement to sell or memorandum of sale, or delivery of, or transfer of the legal title to shares, or certificates of stock, or of profits, or of interest in property or accumulations in any corporation, joint-stock company, or association, or of the right to subscribe for or to receive such shares or certificates, regardless of the time or manner of the delivery of the certificate or agreement or memorandum of sale. [Read at ¶3614 and ¶3998.]

**3591** Art. 10. Rate of taxation.—(a) In the case of stock having a par or face value, the amount of the tax is 2 cents on each \$100 or fraction thereof of the total par or face value of the shares or certificates involved in the sale or agreement to sell, whether such aggregate par or face value is greater or less than \$100; e. g., where the total par or face of the shares involved in the transaction is \$100 or less, the tax is 2 cents; where such value is in excess of \$100, the tax is 2 cents on each \$100 or fraction thereof.

**3592** (b) In the case of shares of stock without par or face value, the tax is 2 cents on the transfer or sale of, or agreement to sell, each share.

**3593** Art. 11. Computation of the tax.—(a) In the case of stock having a par or face value, the amount of the tax is computed upon the total par or face value of the shares and not upon the amount that may have been paid in on such stock; e. g., where stock of the par value of \$100 is sold, for which only \$25 is paid, the tax is reckoned upon the par value of \$100 and not upon the \$25 paid.

**3594** (b) Where one certificate represents several shares (however large the number of shares) on the transfer of such certificate the tax is computed upon its face value and not on the face value of each separate share of stock, or of profits, or of interest in property or accumulations; e. g., on the transfer of one certificate representing 500 shares par value \$5, the face value of the certificate being \$2,500, the stamp tax is 50 cents.

**3594a** (c) In the case of stock without par or face value, the tax is computed on each share; e. g., the tax on the transfer of a certificate for 20 shares of such stock is 40 cents.

**3595** Art. 12. Sales and transfers subject to tax.—(a) The sale, or transfer, or change of ownership, of certificates of stock, or of profits, or of interest in property or accumulations in corporations, joint-stock companies, or associations, is subject to tax. [For transfer from partnership to individual members thereof, see ¶4020: from brokerage firm to successor firm, ¶4024: from bank to its nominee, ¶4026.]



## STAMP TAX REGULATIONS.

- 3598** (b) The sale or transfer of shares of stock, whether or not represented by certificates, is subject to tax.
- 3597** (c) The transfer of stock to or by trustees is subject to tax. [See ¶4000 and ¶4002.]
- 3598** (d) The transfer of voting trust certificates is subject to tax.
- 3599** (e) The sale or transfer of temporary or interim certificates of stock is subject to tax.
- 3600** (f) The sale or transfer of certificates issued by trustees, where such trustees are appointed for a definite period and the declaration of trust provides that the beneficiaries (termed "shareholders") shall hold annual meetings for the election of new trustees to fill the vacancies thus occurring, the beneficiaries thus reserving to themselves control over the persons delegated to conduct their affairs and a voice in the business is subject to tax.
- 3601** (g) The transfer of the interest of a subscriber for stock, however such interest may be evidenced or conditioned upon further payments, is subject to tax.
- 3602** (h) The transfer of the right to subscribe for stock in any corporation, joint-stock company, or association, whether or not evidenced by warrants, is subject to tax.
- 3603** (i) The transfer of the right to receive a stock dividend already declared is subject to tax.
- 3604** (j) The transfer or surrender of stock to a corporation, for the purpose of the corporation, whether or not it intends eventually to sell such stock, is subject to tax.
- 3605** In blank.
- 3606** (k) The sale of or agreement to sell shares of stocks made by a broker, directly or indirectly, for himself, is subject to tax.
- 3607** (l) The sale or transfer of stock by a broker at a price different from that at which he accounts to his selling customer is subject to tax.
- 3608** (m) The transfer of stock in pursuance of a gift, bequest, or conveyance by trustees is subject to tax.
- 3609** (n) The transfer of stock from parties occupying fiduciary relations to those for whom they hold stock is subject to tax.
- 3610** (o) The transfer of certificates of stock by an administrator or executor to the legatee or distributee is subject to tax.
- 3611** (p) The transfer of stock on the books of a domestic corporation, regardless of where the sale is made or the stock certificates delivered, is subject to tax.
- 3612** (q) The sale, transfer, or delivery, within the territorial jurisdiction of the United States, of shares of stock of a foreign corporation is subject to tax.
- 3613** (r) The transfer of stock of a corporation to be merged to the merging corporation prior to the actual merging and as a condition precedent to the merger is subject to tax.

Stamp tax liability on account of transfer of stock incident to the reorganization of a corporation under the laws of another state, without more.—Read at ¶3567

- 3614** Delivery of stock by issuing corporation to another by direction of original subscriber involves a taxable transfer.—Reference is made

## STAMP TAX REGULATIONS.

to your letter of March 18, 1920, requesting a ruling as to whether or not federal stamp tax applies to certain issues and transfers of stock. ¶You are advised that the tax imposed by subdivision 3 of Schedule A, Title II, Revenue Act of 1918, upon the original issue of stock applies when the stock is subscribed for and the subscription is accepted regardless of the time of delivery of the certificate. The direction by the subscriber to deliver such stock to other parties involves the transfer of the right to receive stock and is subject to stamp tax under the provisions of Schedule A-4. (Letter to The Corporation Trust Company, signed by James M. Baker, Deputy Commissioner, and dated March 25, 1920.) [See ¶3998.]

**3615** Art. 13. Sales and transfers not subject to tax.—(a) The transfer of stock pursuant to a sale, where the memorandum of sale has been duly stamped, is not subject to tax.

**3616** (b) The sale or transfer of enemy-owned shares of stock in American corporations to or by the Alien Property Custodian is not subject to tax.

**3617** (c) The surrender of certificates in exchange for other certificates representing the same or new stock, provided they are issued to the same holders, is not subject to tax. [See ¶4002.]

**3618** (d) The surrender of the stock of the consolidating corporation in exchange for stock in the consolidated corporation, in the case of consolidation of two or more corporations, is not subject to tax.

**3619** (e) The transfer of the stock of a merged corporation in exchange for stock of the merging corporation at the time and as a part of a statutory merger is not subject to tax, nor is the substitution of new certificates for the certificates representing the old stock of the merging corporation.

**3620** (f) The surrender of stock for extinguishment or in exchange for new certificates to be issued without change of ownership is not subject to tax.

**3621** (g) The transfer of certificates of stock from the decedent to the administrator or executor of the estate is not subject to tax.

**3622** (h) The sale or transfer of certificates issued by trustees, where such trustees are legally appointed for the entire period of the trust and the beneficiaries retain no substantial control over the affairs of the trust, but delegate their proprietary functions to others, any further control on their part depending upon contingencies, their rights being limited to filling vacancies caused by death, resignation, or disability, is not subject to tax.

**3623** (i) An agreement evidencing a deposit of certificates as collateral security for money loaned thereon, which certificates are not actually sold, is not subject to tax, nor is the delivery or transfer for such purpose of the certificates so deposited, nor the mere loan nor return of stock so loaned subject to tax: *Provided*, That in each case the person making a transfer of such certificates shall make and sign a statement of the facts and attach it to the certificate.

**3624** (j) The transfer or delivery of certificates to a clearing house for the sole purpose of clearing or adjusting accounts, where no beneficial interest is vested in such clearing house and there has been no change of title or interest, is not subject to tax.

**3625** (k) The transfer of a certificate of stock from the owner thereof to a broker, solely for the purpose of enabling such broker to make a sale thereof for the owner, is not subject to tax, provided the broker shall in



## STAMP TAX REGULATIONS.

every case at the time of such transfer to him make and sign a certificate stating that he has no ownership in such stock and that the transfer to him was made solely to enable him to sell the stock for the owner. Such certificate shall in every case be attached to the certificate of stock and presented to the transfer agent at the time such certificate of stock is surrendered for transfer and shall be preserved, together with the old certificate, by such transfer agent, for the inspection of the revenue officer.

**3626** (l) The transfer of a certificate of stock by a broker to his customer for whom and upon whose order he has purchased such stock, where the tax has been paid upon the transfer of the stock to the broker, is not subject to tax, provided that the broker shall in every case, at the time of such transfer from him, make and sign a certificate stating that the transfer from the broker to his customer is made solely to complete the purchase made by such broker for such customer. Such certificate in every case shall be attached to the certificate of stock and presented to the transfer agent at the time such certificate of stock is surrendered for transfer, and shall be preserved, together with the old certificate, by such transfer agent for the inspection of the revenue officer.

**3627** (m) The certificates required by the two preceding paragraphs shall be in the following form: [See ¶4003.]

(1) (In the case of a transfer to a broker)—

We hereby certify that we have no ownership or interest in \* \* \* shares of the stock above transferred, the transfer by the owner to us being merely for the purpose of sale.

.....  
(Broker sign here)

(2) (In the case of a transfer by a broker)—

We hereby certify that the transfer of \* \* \* of the within shares to the names indicated by the star is made solely to complete the purchase made by us for our customer, and we have no ownership or interest therein.

.....  
(Broker sign here)

**3628** (n) No broker who has filed a certificate on the form given in paragraph (1) shall file a certificate on the form given in paragraph (2) with relation to the same transfer of shares of stock.

**3629** In blank.

**3630** Art. 14. Inconsistent by-laws, rules, or customs of exchange.—

No provisions, by-laws, rules or customs of any exchange or similar institution inconsistent with any requirement or provision of the Revenue Act of 1921 or any regulations made thereunder, nor any collateral additional agreement or understanding, either verbal or written, respecting the subject matter of sales or transfers of certificates, or the settlement or fulfillment thereof, which are inconsistent or in conflict with any requirement of said act or regulations shall exempt any person from the payment of the tax imposed.

**3631** Art. 15. Memoranda for sales.—Every person who makes an agreement to sell or transfer title to shares of stock by delivery of certificates assigned in blank, shall as a part of such transaction promptly make and deliver to the buyer a bill or memorandum of such sale or agreement to sell, duly signed by the seller or his agent, to which the requisite stamps shall be affixed and canceled, which bill or memorandum shall show the

## STAMP TAX REGULATIONS.

date of the transaction, the names of the seller and buyer and the name and number of shares of stock, and the price per share and the tax paid thereon, and in the case of a transaction made on an exchange shall bear a number upon the face thereof and have printed and written in ink thereon the words "Subject to the Revenue Act of 1921 and regulations made in accordance therewith." No more than one such bill or memorandum made by the seller on any given date shall bear the same number: *Provided, however,* That no single transaction or purchase or sale that is made upon an exchange by one member to another member shall require to be evidenced by more than one stamped memorandum of sale or agreement to sell.

**3632** Art. 16. Records of sales or transfers of stock.—(a) All persons who are wholly or partly engaged in the business of buying, selling or transferring shares of stock, whether at public or private sale, or whether or not they are members of an exchange, including persons engaged in transactions known as "matched," or "on-order," or "pass-outs," or "give-ups," or settled directly between the seller and buyer, or cleared or adjusted through a clearing house or otherwise, or engaged in accepting and procuring the transmission of orders for purchase or sale of shares of stock shall keep a record showing:

- (1) Date of transaction.
- (2) Line number (if at an exchange).
- (3) Name of broker or salesman who executed the order.
- (4) Name of party to whom sold, or from whom bought.
- (5) Number of shares dealt in.
- (6) Name or description of stock.
- (7) Price of stock, if without face or par value.
- (8) Amount (or total market value) of stock.
- (9) Face or par value of stock per share.
- (10) Tax paid on shares having face or par value.
- (11) Tax paid on shares without face or par value.
- (12) State tax paid, if any. (Optional.)
- (13) Total amount to ledger. (Optional.)
- (14) Folio number. (Optional.)
- (15) Name of customer for whom sold or transferred, or for whom bought or transferred.
- (16) Method of settlement or adjustment.

**3633** (b) Persons keeping such records may incorporate therein additional columns that will be of use to them, such columns to be placed so as not to interfere with the columns and headings hereby prescribed. These records must be in book form, and all entries therein must be legibly written in ink and the records kept for a period of at least two years. Such record forms will not be supplied by the department.

**3633** (c) The form of record required shall be substantially as follows: [For a, the form see page 719.]



## STAMP TAX REGULATIONS.

Form A.

(Name of person (firm or individual broker) keeping the record.)

Address.....

(Street and number.)

(City.)

(State.)

\*Clearing-House Transactions.

{ N. B.—Clearing-house transactions and ex-clearing-house transactions must be recorded separately, either in a separate record or blotter with the proper headings, etc., if the volume of the business so warrant; or else distinctly segregated on the same page or another section of the record in the form hereby prescribed.

\*Ex-Clearing-House Transactions.

\*Erase line not applicable.

SALES (TO DELIVER) (A)

Date B
Line No. (if at an exchange) (C)
Name of broker or salesman who executed order
To whom sold (D)
Number of shares.
Name or description of stock.
Price of stock if there is no face (or par) value
Amount (or total market value).
Face (or par) value of stock per share
Tax paid on shares having face (or par) value (E)
Tax paid on shares without face (or par) value (F)
State tax (if any). (GH)
Total amount to ledger. (H)
Folio No. (H)
Name of customer (for whom sold or transferred). (I)
Loaned shares (J)
Borrowed shares returned (K)
Method of settlement or adjustment. In case of recording clearing-house transactions it is permissible to state: "All transactions entered hereon are settled through clearing house except balances listed below," or in case of ex-clearing house transactions to state "Numbers indicate deliveries by (or to) us." All other settlements whether by "offset," "matched," "on order," "pass out," "scratch sale," "give up," or otherwise, must be entered opposite each transaction.

Directions.—All entries must be legibly written in ink and this record or "Blotter" or "Purchase and Sales book" must be preserved for a period of at least two (2) years. The reverse side of this sheet is for "Purchases (to receive)," therefore make the captions and headings on the "Purchase" side to conform, viz.:

(A) The words "Purchases (to receive)" in lieu of "Sales (to deliver)."

(B) The date may be printed or stamped at the top of the page or section dividing each day's business.

(C) Each entry in this record shall have a number identical with the line number identifying the transaction with the memorandum of sale, transfer, or delivery mentioned in article 15 of Regulations No. 40, Revised.

Fifty lines to the page may be used.

The numbers in this column on the "Sales" side may be printed from 51 to 100 inclusive, and on the "Purchase" side from 1 to 50 inclusive.

(D) The words "from whom bought" in lieu of "to whom sold."

(E) (F) (G) The filling in of these three columns on the "purchase" side is optional.

(H) The incorporation of these and additional columns, such as "Interest," "Commissions," "State tax," etc., is optional with the person keeping the record.

(I) The words "for whom bought or transferred" in lieu of the words "for whom sold or transferred."

(J) The word "loaned" in lieu of the word "loaned."

(K) The words "loaned shares returned," in lieu of the words "borrowed shares returned."

## STAMP TAX REGULATIONS.

**3634** (d) *Provided, however,* That brokers known as strictly "floor brokers," or "two dollar men," or "room traders," in lieu of the foregoing record, whether their transactions are settled directly between seller and buyer or by "matched," "on-order," "pass-out," or "scratch sale," or "give-up," or any other kind of sale or purchase, or are cleared through a clearing house or otherwise, shall keep a record showing:

- (1) The date of the transaction.
- (2) The name of the seller.
- (3) The name of the purchaser.
- (4) The name of the stock.
- (5) The number of shares.
- (6) The par or face value of the shares.
- (7) The price, if the stock has no par value.
- (8) Whether the transaction is "matched," "on-order," "pass-out," "scratch sale," or "give-up."
- (9) Name of person to whom "given-up."

**3635** (e) *Provided further,* That persons engaged in accepting and procuring the transmission of orders for the purchase or sale of shares of stock to be executed at a brokerage office or an exchange, board of trade, or similar place, shall keep a record showing:

- (1) Date of acceptance and transmission of order.
- (2) Name of person from whom accepted.
- (3) Name and address of person to whom transmitted.
- (4) Name of stock.
- (5) Par value of stock.
- (6) Number of shares.
- (7) Whether purchase or sale.
- (8) Price.
- (9) Whether order was executed at an exchange; and, if so, what exchange.
- (10) Date of execution of order.

**3636** **Art. 17. Returns by persons making sales.**—(a) All persons who are wholly or partly engaged in the business of buying, selling or transferring shares of stock, whether such sales, purchases, or transfers shall be made, cleared, settled, or adjusted through a clearing house, or otherwise, shall on or before the fifteenth day of each month, and at any other time designated by the Commissioner, render under oath a true return of all such sales and transfers for the preceding month or for any other period designated by the Commissioner. This return should be made to the collector of internal revenue for the district in which such person or persons are located, and should contain in detail the following data and information:

- (1) The month for which the return is made.
- (2) The name and address of the person, partnership, corporation, or association making the return.
- (3) The number of shares sold, loaned, and borrowed returned, and tax paid as follows:
  - (a) Par value shares through clearing house.
  - (b) Par value shares ex-clearing, curb, over the counter.
  - (c) No par value shares, market value \$100.00 or less through clearing house.
  - (d) No par value shares, market value \$100.00 or less ex-clearing house, curb, over the counter.



## STAMP TAX REGULATIONS.

- (e) No par value shares, market value over \$100.00 through clearing house.
- (f) Market value no par value shares, market value over \$100.00 through clearing house.
- (g) No par value shares, market value over \$100.00 ex-clearing house, curb, over the counter.
- (h) Market value no par value shares, market value over \$100.00 ex-clearing house, curb, over the counter.
- (i) Transfers, calls, rights, when as and if issued, contracts, and miscellaneous
- (4) Number of shares cross trades.
- (5) The amount of tax paid
- (6) The amount of stamps on hand on the first day of the month, or other period.
- (7) The amount of stamps purchased during the month, or other period.
- (8) The amount of stamps on hand on the last day of the month for which return is being made.

**3637** (b) Provided that brokers known strictly as "floor brokers," or "two-dollar men" or "traders" in lieu of the foregoing return shall render a return only as to such sales as were not "given up" to or cleared through some other broker including direct settlements, "pass-outs," or "scratched sales."

**3638** (c) Provided further that in the event any broker who has not closed business shall make no sales of stock during any one month he shall file with the Commissioner a statement to that effect in lieu of a return.

**3639** Art. 18. Returns by clearing houses.—(a) If any person, who negotiates sales or transfers of stock on a stock exchange, shall appoint in writing the clearing house for the exchange upon which such sales or transfers are made his agent for the purposes hereinafter indicated, and shall make to such clearing house a written return, statement, or sheet, on each business day, containing a full disclosure of all such transactions, both clearable and non-clearable, of the preceding day, in shares of stock that are listed or permitted to be dealt in by such member on such exchange, and also showing which, if any, of such stocks are loaned or borrowed or returned, then in that event such return, statement, or sheet, delivered to the clearing house, shall be deemed to be the bill, or memorandum of sale, or agreement to sell, required under subdivision 3, Schedule A, Revenue Act of 1921, and such clearing house is hereby authorized to affix to such return, statement, or sheet the amount of stamps required for each sale or agreement to sell or memorandum of sale or delivery or transfer of the stock indicated thereon, and to cancel the stamp so affixed.

**3640** (b) The affixing and cancellation of such stamps by the clearing house shall be held to be the act of the person making such sale or agreement to sell, or memorandum of sale, or delivery or transfer of such stock; or if such person and clearing house so elect, such person shall affix and cancel such stamps before delivering such clearing house sheets or memoranda of sales to the clearing house, but such clearing house shall not accept such clearing house sheet or memoranda unless stamps for all transfer tax required to be affixed are attached thereto and properly cancelled.

## STAMP TAX REGULATIONS.

**3641** (c) The returns, statements or sheets made to the clearing house shall in respect of each sale show the date thereof, the name of the seller, the name of the buyer, the amount of the sale, and the name of the stock, or certificates, or other things traded in, but a return for more than one sale may be made upon the same return, statement, or sheet; and no settlement of differences or other dealings between members shall be permitted that will interfere with the full disclosure of the whole transaction.

**3642** (d) Said clearing house shall preserve the returns, statements, or sheets so made and stamped for at least two years.

**3643** (e) Such return, statement, or sheet to the clearing house shall not relieve the seller from making and delivering to the buyer the bill or memorandum required by article 15 of these regulations.

**3644** (f) Wherever any clearing house carries upon its sheets or records information or reports of transactions showing the transfer by one of its members of an account of a customer without change of ownership of the securities of the customer, there shall be kept by the members of such clearing house or body concerned in such transaction a record showing the particulars of such transaction.

**3645** Art. 19. Stock transfer stamps.—(a) Ordinary documentary stamps with the words "Stock transfer" overprinted thereon, known as "Stock transfer stamps," shall be affixed to all sales or agreements to sell, or memoranda of sales, or deliveries of or transfers of legal title to shares or certificates of stock or of profits, or of interest in property or accumulations of a corporation, joint-stock company, or association, and all "warrants," rights, and other securities, made at exchanges or similar places.

**3646** (b) Ordinary documentary stamps may be affixed to sales, agreements to sell, or memoranda of sales not made at exchanges or similar places.

## PART III.

## SALE OF PRODUCTS OR MERCHANDISE AT OR UNDER THE RULES OR USAGES OF EXCHANGES FOR FUTURE DELIVERY.

**3647** Art. 20. When tax accrues.—The stamp tax on sales of products  
3528 or merchandise for future delivery accrues immediately upon the making of a sale, agreement of sale, or agreement to sell, and is in no wise dependent upon the manner of delivery of the product.

**3648** Art. 21. Rate of taxation.—The rate of taxation is 2 cents on each \$100 or fraction thereof of the value of the products or merchandise involved in the sale, agreement of sale, or agreement to sell.

**3649** Art. 22. Transactions subject to tax.—All sales or agreements to sell (except as herein otherwise provided) of products or merchandise at or under the rules and usages of an exchange for future delivery are subject to the payment of tax, and every sale or agreement not evidenced by a memorandum or contract expressly requiring immediate or prompt delivery shall be deemed to be for future delivery. In cases in which the commissioner is not satisfied from the evidence that the transaction is in good faith intended to be followed by immediate or prompt delivery, the seller is required to pay the tax as on a sale for future delivery.

**3650** Art. 23. Transactions not subject to tax.—(a) So-called "transfer or scratch sales" or "pass-outs" are not subject to the tax: *Provided*,



## STAMP TAX REGULATIONS.

That the purchase and sale are made at the same exchange on the same day, at the same price, and for the account of the same person.

**3651** (b) Cash sales of products or merchandise for immediate or prompt delivery, which are in good faith actually intended for "immediate or prompt delivery", as defined in article 33 (3) (d) of these regulations, are not subject to tax.

**3652** (c) Transfers of sales, agreements of sale, or agreements to sell, to a clearing house by a person selling products or merchandise on exchange for future delivery who have paid the tax provided by law, are not subject to tax, provided such transfers do not vest any beneficial interest in the clearing house and are made for the sole purpose of enabling the clearing house to adjust and balance the accounts of members of the exchange and of such clearing house on their contracts.

**3653** Art. 24. Inconsistent by-laws, rules, or customs of exchanges.—

No provisions, by-laws, rules, or customs of any exchange, board of trade, or similar institution or place of business which are inconsistent or in conflict with any requirement or provision of the Revenue Act of 1921, or any regulations made thereunder, nor any collateral, or additional agreement, verbal or written, respecting the subject matter of such contract or the settlement or fulfillment thereof which is inconsistent or in conflict with any requirement of said act or regulations, shall exempt any person from the payment of tax imposed by subdivision 4 of said act.

**3654** Art. 25. Memoranda of sales.—(a) Every person who makes sales, or agreements of sale, or agreements to sell, any products or merchandise at or under the rules or usages of any exchange, board of trade, or similar place, for future delivery, shall deliver to the buyer bill, memorandum, or other evidence of such sale, agreement of sale, or agreement to sell, to which there shall be affixed a lawful stamp in value equal to the amount of the tax on such sale.

**3655** (b) Such bill, memorandum, or other evidence duly stamped shall be kept by the buyer for two years, unless otherwise prescribed in these regulations.

**3656** (c) No single sale or agreement of sale, or agreement to sell, made upon an exchange by one member for another need be evidenced by more than one stamped bill, memorandum, or agreement.

**3657** Art. 26. Clearing house as agent.—(a) If any person who makes sales, agreements of sale, or agreements to sell any products or merchandise at or under the rules or usages of any exchange, board of trade, or similar place, for future delivery, shall in writing appoint the clearing house for the exchange upon which such sales are made, his agent for the purpose hereinafter named, such clearing house being approved by the commissioner, and shall make a written return or sheet of each such sale to such clearing house in accordance with these regulations, such return or sheet shall be deemed to be the bill, memorandum, or other evidence required by these regulations to be delivered by the seller to the buyer and the clearing house is hereby authorized to affix to such return or sheet the amount of the stamps required for each sale, agreement of sale, or agreement to sell as indicated thereon and to cancel the stamps so affixed.

**3658** (b) The affixing and canceling of such stamps by the clearing house shall be held to be the act of the person making such contract of sale.

## STAMP TAX REGULATIONS.

**3659** (c) If the person making such sale and the clearing house so elect, the seller may affix the stamps to the clearing house return or sheet and cancel the same before or at the time of delivery to the clearing house. The clearing house shall in no event accept such bill, memorandum of sale or clearing house return or sheet unless stamps for all the tax required to be paid thereon are attached and properly canceled.

**3660** (d) The returns or sheets of sales so made to the clearing house shall in respect of each sale, set forth the date, the name of the seller, the name of the purchaser, the amount of the sale, the matter or things to which it refers, and the tax paid thereon, but a return for more than one sale may be made on the same paper or sheet.

**3661** (e) The clearing house shall preserve for a period of not less than two years, each bill, memorandum or return, or sheet made to it by such person.

**3662** (f) Every clearing house shall include in its monthly return to the commissioner a statement of the amount of stamps so affixed and canceled on the returns or sheets of each person.

**3663** (g) The making of such return by the clearing house shall not relieve the person making such sale, or agreement of sale, or agreement to sell, from making the monthly return of his transactions required by Art. 29 of these regulations.

**3664** Art. 27. Records to be kept by buyers and sellers.—(a) All persons who make sales or agreements of sale of, or agreements to sell (including so-called "transferred or scratch" sales, "pass outs," "pair offs," "matched trades," or "give ups") any products or merchandise at, or under the rules or usages of, any exchange for future delivery, or are engaged in the business of accepting and transmitting orders for the purchase of such products or merchandise to be executed at, or under the rules or usages of any exchange for future delivery, shall keep a record showing:

- (1) Date of contract.
- (2) Name of person executing contract (floor broker).
- (3) To whom sold or from whom bought (name and address).
- (4) Whether transaction is a purchase or sale
- (5) Quantity of product or merchandise involved, whether in tons, pounds, bales, bushels, bags, mats, barrels, gallons, or whether other units of weight or measure are used.
- (6) Name of products or merchandise, including (if not a basis grade) grade, type, sample, or description.
- (7) Whether contract is a "basis-grade," "deferred-acceptance," or whatever kind of contract.
- (8) Price specified per ton, pound, bale, bushel, bag, mat, barrel, gallon, or whatever other unit of weight or measure is used.
- (9) Tax paid.
- (10) Customer (name and address).
- (11) Origin of order (whether domestic or foreign).
- (12) Month or time specified in contract for delivery.
- (13) Date of settlement.
- (14) Method of settlement or adjustment.

**3665** (b) *Provided*, That "floor brokers," or "two-dollar men," or "room traders", in lieu of the foregoing record, shall keep a record showing:

- (1) Date of transaction.
- (2) Name of person who executed the order, if other than the floor broker.



## STAMP TAX REGULATIONS.

- (3) Name of seller.
  - (4) Name of buyer.
  - (5) Quantity of product or merchandise involved in the transaction.
  - (6) Name of product or merchandise, including (if not a basis-grade contract) grade, type, sample, or description.
  - (7) Whether the contract is a basis-grade contract.
  - (8) Price.
  - (9) Time specified in contract for delivery.
  - (10) Name of persons to whom "given up," "paired off," "transferred or scratched," or "passed out."
- 3666** (c) Any other transactions than those specified in this proviso made by "floor brokers," "two-dollar men," or "room traders," shall be kept on the first form prescribed in this article.
- 3667** (d) Persons who use either of such forms may incorporate additional columns which may be of use to them, such columns to be so placed as not to interfere with the columns and headings herein prescribed.
- 3668** (e) Such record forms will not be supplied by the department.
- 3669** (f) The foregoing records shall be legibly written in ink, and contracts of sale for future delivery of two or more distinct products or merchandise shall be kept separate. Each person who executes or makes such contracts of sale shall preserve the books, bills, memoranda, "sales tickets," or trading cards of all transactions, and the purchaser shall preserve the bill, memorandum, agreement, or evidence of sale to which the stamps are affixed for the period of two years, that they may be readily inspected by the revenue officer.
- 3670** (g) The form of record required by these regulations shall be substantially as follows:

[For copy of form see page 726.]

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## Form B

..... [Name of person (firm or individual broker) keeping the record.]

Address: ..... (Street and number.) ..... (City.) ..... (State.)

SALES OF (a) ..... (b) FOR ..... (c) 19 ..... DELIVERY.  
 [Name of product or merchandise including (if not a basis  
 grade) grade, type, sample, or description.] [Month or time specified in contract for delivery.]

..... (d)  
 [State on the above line whether the contract is a "basis grade" contract, "deferred acceptance" contract or whatever name or term.]

The contracts here recorded } Transactions made "under the rules or usages of any exchange..... for future delivery."  
 were made on the } must be segregated and the facts fully stated, giving name and address of exchange in  
 each instance hereon.....

Date.	Name of person executing con- tract (floor broker.)	To whom sold (name and ad- dress) e	Quantity.	Name of product or merchan- dise in- cluding (if not a basis grade) type, sample or descrip- tion. (See note below.) f	Price. Tax paid. (g)	Customer (name and address).	Origin of order	Settlements or adjustments.	
							Domestic.	The method or settlement, whether by actual delivery or receipt of the product, or merchandise by notes, "effects," either clearing, house or "direct," rings, "crossed," "pair-off," "matched," or "crossed," "trans- ferred," "scratch," "give-ups," "broker- ages," or "clearances," or if "privi- leges," or "orders of indemnities," or "deferred acceptance contracts," whether the option or offer was exercised or, "made good" or ex- pired, and date of same; or any other settlement by whatever name or term must be entered opposite each transaction. Columns for that and other purposes may be incor- porated if desired.	Date of settle- ment.
							Foreign.		

Directions.—All entries must be legibly written in ink and this record must be preserved for a period of at least two (2) years. The form of record for "Purchases" shall be the same as the above except that the necessary changes in captions, headings, etc., must be made, viz  
 (a) "Purchases" in lieu of "Sales."  
 (b) In cases where contracts are made on description (not basis-grade contract) an additional column (f) must be incorporated between columns headed "Quantity" and "Price."

(c) Months of delivery must be kept separate.

(d) All blanks must be filled in.

(e) "From whom bought" in lieu of "To whom sold."

(f) See also (b) and (d), and this column (f) may be omitted if proper heading is provided.

(g) "Tax paid" column may be omitted on "Purchase" side.

Fifty (50) lines to the page may be used.



## STAMP TAX REGULATIONS.

**3671 Art. 28. Records to be kept by clearing houses.**—(a) All persons who act in the capacity of a clearing house shall keep a record showing:

- (1) Name of person for whom each contract is cleared.
- (2) Date when contract was made.
- (3) Whether the transaction is a purchase or sale.
- (4) Quantity of product, or merchandise, involved, whether in tons, pounds, bales, bushels, bags, mats, barrels, gallons, or other unit of weight or measure, as the case may be.
- (5) Name of product, or merchandise, including (if not a "basis-grade" contract) grade, type, sample, or description.
- (6) Whether the contract is a "basis-grade" contract.
- (7) Time specified in contract for delivery.
- (8) Date of settlement.
- (9) Method of actual settlement.

**3672** (b) Records of sales for future delivery of two or more distinct products or merchandise must be kept separate.

**3673** (c) The clearing house shall preserve such records for the term of two years.

**3674** (d) Such record forms will not be supplied by the department.

**3675 Art. 29. Returns of transactions.**—(a) All persons who make contracts of sale or purchase of any product or merchandise, at or under the rules or usages of any exchange, board of trade, or other similar place of business, for future delivery, whether such contracts shall be cleared and adjusted through a clearing house, or directly between the seller and buyer, or otherwise, shall on or before the fifteenth day of each month, or at any other time required by the Commissioner, make a return in writing to the Commissioner, for the preceding month or any other period, verified before some officer authorized to administer oaths, showing:

- (1) The number of contracts of sale and purchase of each product or merchandise brought forward from the preceding month or period.
- (2) The number of contracts of sale and purchase of each product or merchandise on each day during the current month or period.
- (3) The month in which the products or merchandise are to be delivered.
- (4) The method of settlement of each contract, i. e., whether by "actual delivery," "notice," "ring," "direct," "transfer," "scratch sale," "pass out," "matched," "pair off," "set-off," "give up," through a clearing house or otherwise.
- (5) The tax paid thereon.
- (6) The number of contracts both of purchase and sale carried forward at the end of the month or period.
- (7) The amount of stamps on hand at beginning of month or period.
- (8) The amount of stamps purchased during month or period.
- (9) The amount of stamps used during month or period.
- (10) Balance of stamps on hand at end of month or period.
- (11) The origin of the order or the contracts, whether domestic or foreign.

**3676** (b) *Provided*, That "floor brokers," or "two-dollar men," or "room traders" may omit from their returns information called for under paragraphs marked (1), (6), and (11). But in the event such "floor brokers," "two-dollar men," or "room traders" shall make or settle transactions in any other way than by "transferred or scratch sales," "give ups," or "pass outs," they shall make the full returns prescribed in this article.

## STAMP TAX REGULATIONS.

**3677** (c) Such returns shall be made upon forms to be furnished, upon application, by the collector of internal revenue, of the district in which the exchange, board of trade, or other similar place is located.

**3678** Art. 30. Returns by clearing houses.—(a) Every clearing house shall on or before the fifteenth day of each month, and at such other times as required by the Commissioner, make return in writing, under oath, to the Commissioner, for the preceding month or other period, showing:

- (1) The number of open contracts "long" and "short" brought forward for each member from the preceding month
- (2) The number of contracts bought and sold by each member of the association.
- (3) The number of tons, pounds, bales, bushels, bags, mats, barrels, or gallons, or other units of weight or measure involved in such contracts, as the case may be.
- (4) The month in which such product, merchandise, or commodity is to be delivered.
- (5) The method of settlement of said contracts, i. e., whether by "set off," "notice," or "delivery," or by what method.
- (6) Total tax paid by each member of the exchange.
- (7) The number of open contracts "long" and "short" carried forward for each member to the following month.

**3679** (b) Such returns shall be made upon forms to be furnished, upon application, by the collector of internal revenue of the district in which the clearing house is situated.

**3680** Art. 31. Stamps may be affixed to returns.—(a) If any exchange shall by proper resolution request the Commissioner to permit the members of such exchange to affix the requisite amount of stamps on the returns made by such members to the Commissioner of all transactions made by such member at such exchange and cancel such stamps, and shall file with the Commissioner a copy of the charter and by-laws of such exchange accompanied with a list of the names and addresses of the officers and members of such exchange, designating those of such members who are active and those who are inactive on the exchange, then upon approval of such resolution by the Commissioner, instead of affixing the stamps to the bill or memorandum of sale as now required, it shall be lawful for the members of such exchange to affix the amount of stamps on such returns as shall represent the aggregate amount of tax due on all sales, agreements of sale, or agreements to sell, made by such member during the preceding month or other period designated by the Commissioner and such stamps shall be canceled by such member in the manner prescribed in these regulations.

**3681** (b) Such returns, duly stamped, shall be filed and preserved for two years.

**3682** (c) The stamping and filing of such returns shall not in any way relieve the members of such exchange from making and delivering to the buyer the memorandum or bill of sale prescribed by law and these regulations, nor the buyer from the necessity of preserving the same for the term of two years.

**3683** Art. 32. Future delivery stamps.—The stamps to be used on sales, agreements of sale, or agreements to sell products or merchandise at or under the rules or usages of any exchange, or board of trade, or other



## STAMP TAX REGULATIONS.

similar place, for future delivery shall be the ordinary documentary stamps with the words "Future delivery" overprinted thereon, and they shall be known as "Future delivery stamps."

## PART IV.

## DEFINITIONS AND GENERAL PROVISIONS.

**3684** Art. 33. Further definitions.—(1) When used in these regulations:  
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**3685** (a) The term "person" includes the plural as well as the singular, also individuals, partnerships, joint-stock companies, associations, and corporations, except when from the context it is plain that a different meaning is intended;

**3686** (b) The term "issue" includes not only actual delivery of, but also acceptance of subscriptions to shares or certificates of stock, or of profits or of interest in property or accumulations in any corporation, joint-stock company, or association;

**3687** (c) The term "reorganization" includes those business arrangements whereby the stock and bonds of a corporation are readjusted as to amount, income, or priority, or the property is sold to a new corporation for new stock and bonds, or is sold by the foreclosure of a mortgage upon it to a purchaser who buys for himself and his associates, and the various proceedings and transactions by which succession of corporation is brought about, and also the proceedings by which existing corporations are continued under a different organization without the creation of a new corporation;

**3688** (d) The term "broker" includes not only those persons defined as brokers in the Revenue Act of 1916, but also persons defined as commission merchants and commercial brokers under the Revenue Act of 1914, except those persons classed as commercial brokers under the Revenue Act of 1914 whose business it is to negotiate freight and other business for the owners of vessels or for shippers or consignors or consignees of freight carried by vessels, who, in the Revenue Act of 1918, are classed as ship brokers;

**3689** (e) The act, omission, or failure of any official, agent or other person or corporation, employed by any person, partnership, company, association, or corporation, within the scope of his employment or office, shall in every case be deemed also the act, omission, or failure of such person, partnership, company, association, or corporation.

**3690** (2) As used in Parts I and II of these regulations:

**3691** (a) The term "sale" or "transfer" includes sales, agreements to sell, memoranda of sales, or deliveries or transfers of legal title to shares or certificates of stock, except as otherwise specifically provided in these regulations;

**3692** (b) The term "agreement to sell" includes options, calls in "puts and calls," offers, indemnities and privileges, and contracts, either in writing or by parol, to sell on the deferred or partial payment plan;

**3693** (c) The term "share of stock" includes shares and certificates for shares of stock representing interest in corporations, joint-stock companies or associations, or interest in profits or in property or in accumulations in a corporation, and certificates for shares or interest in shares "if, as and when issued," and rights to subscribe for stock or interest in profits or in property or in accumulations, in any corporation;

## STAMP TAX REGULATIONS.

**3694** (d) The term "exchange" includes each and every agency, office, room, or other place of assembly whether under shelter or in the open, at which stock, rights, warrants, interests in property, or in profits, or in accumulations, by corporations, are publicly bought, sold, bid for, offered or exchanged between persons there assembled, in behalf of themselves or others;

**3695** (e) The term "clearing house" includes every corporation or association, whether incorporated or not, of individuals, partnerships or corporations wholly or partly engaged in the business of clearing, settling, or adjusting transactions in the purchase, sale, receipt, or delivery of shares of stock, whether or not the same be a part or department of an exchange or an independent body.

**3696** (3) As used in Part III of these regulations:

**3697** (a) The term "sale" or "contract of sale" includes all sales, or agreements of sale, or agreements to sell, including so-called transfers or "scratch sales";

**3698** (b) The term "agreement of sale" or "agreement to sell," includes options, calls in "puts and calls," offers, indemnities, and privileges;

**3699** (c) The term "transferred or scratch sale" includes "pass-outs" or those transactions in which a person buys from another a certain quantity of any product, at a certain price, and at the same session of an exchange, sells to a third person the same quantity of the same product at the same price, and eliminates himself by instructing the person from whom he brought to deliver such product to the person to whom he sold; but no transaction in which a broker or a commission member of an exchange receives a commission greater than that charged to a person who executes his own contracts shall be deemed to be a "transfer" or a "scratch sale";

**3700** (d) The term "immediate or prompt delivery" means delivery at once or as soon as practical, and in any event within twenty days of the date of the sale, or agreement of sale, or agreement to sell;

**3701** (e) The term "exchange," except where it is plain from the context that a different meaning is intended, includes each and every agency, board of trade, bourse, auction place, or other meeting place, whether under shelter or in the open, at which products or merchandise are publicly bought, sold, bid for, offered, or exchanged, for future delivery, or contracts for such future delivery are made, either between members of such exchange, or between members and nonmembers, patrons, and the public; and includes places at which there is only one manager or firm, who controls all the sales and purchases at that particular place or where no actual delivery of the products or merchandise is contemplated, and all incorporated and unincorporated associations of individuals, partnerships, and corporations engaged in the business of publicly selling, buying, or exchanging products or merchandise for future delivery;

**3702** (f) The term "at an exchange" means near to or in close proximity to or in the immediate vicinity of an exchange, as well as on the floor of an exchange;

**3703** (g) The term "clearing house" includes each and every person, corporation, association, or committee engaged in the business of clearing, settling, and adjusting transactions in the purchase, sale or delivery of products or merchandise, whether such clearing house be a part or department of an exchange or an independent body.



## STAMP TAX REGULATIONS.

**3704** Art. 34. Registration.—(a) Every person engaged, in whole or in part, in any of the following businesses or activities shall file a statement for registration with the collector of internal revenue of the district in which his principal office or place of business is located:

**3705** (1) Persons engaged in negotiating, making, or recording sales, agreements to sell, deliveries or transfers of shares or certificates of stock, or rights, or warrants, or certificates of beneficial interest in profits, property, or accumulations of a corporation.

**3706** (2) Persons conducting or transacting a stock brokerage business.

**3707** (3) Persons accepting or procuring the transmission of orders for the purchase or sale or transfer of stocks, rights, warrants, certificates of beneficial interest or interests in property, profits, or dividends, to be executed at a stock brokerage office or an exchange or similar place.

**3708** (4) Persons engaged in the business of transferring stock other than their own.

**3709** (5) Persons engaged in making sales or agreements of sale of, or agreements to sell, any products or merchandise at, or under the rules or usages of, any exchange, for future delivery; or engaged in the business of accepting or procuring the transmission of orders for such contracts of sale to be executed at an exchange, or under the rules or usages of an exchange, for future delivery.

**3710** (6) Persons engaged in conducting an exchange or clearing house or clearing association for the clearing, adjusting, and settling transactions, made on exchanges or similar places: *Provided*, That in case the person conducting such an exchange has a department connected therewith engaged in clearing, adjusting, and settling transactions made on such exchange, he shall so state and shall give the names and addresses of the superintendent and secretary of such clearing house division or committee.

**3711** (b) If the person required to file a statement for registration is also a member of an exchange, a seat on which is worth \$2,000 or more, he shall state the average value of such seat for the year ending June 30 immediately preceding his registration.

**3712** (c) In the case of a partnership of which two or more members are members of exchanges, the names of such members and of each exchange in which memberships are held shall be stated, together with the price of a seat on each exchange.

**3713** (d) The statement above required shall be verified on oath by the person required to make such statement, or by the president or secretary of a corporation, association, or clearing house, and shall set forth specifically the character of the business to be conducted and the full name and address of each person or member of a partnership engaged in such business: *Provided*, That, in the case of a corporation or association, the statement for registration shall set forth the date and place of incorporation and the principal office or place of business both within and without the State where incorporated, with the names and addresses of the chief officer and secretary of such corporation, and be accompanied with a list of the members and their addresses.

**3714** (e) Each exchange or clearing house shall also file with such collector a copy of its constitution, charter, or agreement of association and by-laws, rules and regulations, and all amendments thereto as the same may from time to time be adopted, and the names and addresses of new members as from time to time admitted to membership.

## STAMP TAX REGULATIONS.

**3715** (f) If the person or corporation required to file such statement has been licensed under the laws of any State or under any other provision of Federal law the date and place at which such license was issued shall be stated.

**3716** (g) In case a person registered as required by these regulations shall suspend or close his business before the end of the year for which he is registered, he shall file in the office of the collector of internal revenue in which he is registered a certificate to that effect, giving the date on which he suspended or closed his business.

**3717** (h) Such statement for registration shall be made on a form to be furnished upon application to the collector of internal revenue.

**3718** Art. 35. Record of registration kept by collector.—(a) Every collector shall file and preserve each statement for registration filed with him in accordance with these regulations, and shall issue to each person, partnership, exchange, clearing house, or corporation a certificate of registration, showing the date of issue, the name of the person, or exchange, clearing house, or corporation, conducting the business, the nature of the business for which the license is granted, and the date of expiration of said registry, which certificate of registration shall be signed by the collector, and shall be posted in some prominent place in the office of said person, partnership, exchange, clearing house, or corporation during the period for which it is issued.

**3719** (b) If such business is conducted at more than one place, a certificate shall be so posted in each such place of business.

## BROKERS.

**3720** Art. 36. Brokers.—(a) The special tax paid by a firm or corporation as broker, covers individual members of the firm or corporation, as long as such members are trading solely for the benefit of the firm or corporation.

**3721** (b) A broker who owns a single seat only in one exchange is required to pay the special tax of \$50 per year and in addition a tax at the rate of \$100 or \$150 per year, according to the value of the seat in the exchange or organization of which he is a member.

**3722** (c) If a broker owns a seat in more than one exchange, the additional tax which he is required to pay is the sum of the taxes upon all the seats owned by him.

**3723** (d) If a broker owns more than one seat in the same exchange, he is subject to the additional tax only upon the value of a single seat.

**3724** (e) If a partnership or corporation owns a number of seats in the same exchange, but holds such seats in the name of the individual members of the partnership or corporation who transact business solely for the benefit of the partnership or corporation, the tax on the ownership of such seats or memberships in such exchange shall not apply to each individual in the partnership or corporation, but only to one seat or one membership.

**3725** (f) Where the possession of shares of stock is a prerequisite to membership in an exchange, the lessee of a share of stock in such exchange is liable for the additional tax imposed by subdivision 1 of section 1001 [¶7502].



## STAMP TAX REGULATIONS.

## AFFIXING AND CANCELLATION OF STAMPS.

- 3726** Art. 37. Affixing and cancellation of stamps.—(a) In the case of  
 3514 the issue of shares of stock, whether on organization or reorganiza-  
 3522 tion, the stamps representing the tax shall be affixed to the stock  
 books and not to the certificates issued.
- 3727** (b) In the case of a sale before certificates are issued, where the  
 evidence of transfer is shown only by the books of the corporation,  
 the stamps shall be placed on such books.
- 3728** (c) In case the change of ownership is effected by transfer or de-  
 livery of the certificate, i. e., where the name of the transferee is  
 inserted in the indorsement or power of attorney on the back of the certi-  
 ficate, the stamp shall be affixed to such certificate and canceled by the  
 person making the sale.
- 3729** (d) In case of agreement to sell, or where the transfer is by delivery  
 of the certificate assigned in blank, the stamp shall be affixed to the  
 bill, memorandum, or agreement to sell, and canceled by the seller.
- 3730** (e) In no event shall any transfer agent or corporation accept or  
 transfer any shares of stock or certificates unless stamps for all  
 transfer tax required thereon have been properly affixed either to the certi-  
 ficates of stock or memoranda of sale, as the case may be, and duly canceled.
- 3731** (f) The person using or affixing the stamp shall write or stamp  
 3513 thereon, in ink, his initials and the day, month, and year on which  
 the same shall be affixed, or shall, by cutting or canceling with a  
 machine or punch, affix his initials and the date as aforesaid, and so deface  
 such stamp as to render it unfit for reuse. In addition to the foregoing, stamps  
 of the value of 50 cents or more shall have three parallel incisions made  
 with some sharp instrument lengthwise through the stamp after the same  
 has been attached to the certificate or bill, or memorandum, or other  
 evidence of sale or transfer: *Provided*, That this shall not be required where  
 stamps are canceled by perforation: *And provided further*, That the cancella-  
 tion by either method shall not so deface the stamp as to prevent its denom-  
 ination and genuineness from being readily determined.

## PART V.

## ADMINISTRATIVE.

[¶3515, ¶8000-2, ¶8064, and ¶8071-2]

- 3732** Art. 38. Failure to make returns; substitute returns.—(a) If  
 any person or clearing house required to make returns by this Act  
 or the regulations thereunder shall fail or refuse to make any such return  
 within the time prescribed by these regulations or designated by the Com-  
 missioner, then the same shall be made by an internal-revenue officer upon  
 the inspection of the books of the person or clearing house so required,  
 but the making of such return by an internal revenue officer shall not relieve  
 the person or clearing house from any default or penalty incurred by reason  
 of failure to make such return.
- 3733** (b) Any officer designated by the Commissioner shall have authority  
 to examine the books, papers, and records kept pursuant to these  
 regulations, and may require the production of any books, records, papers  
 or statements of account necessary to determine any liability to the tax  
 imposed by this Act or the observance of the provisions of the regulations  
 made in accordance therewith.

## STAMP TAX REGULATIONS.

## SALE OF STAMPS.

**3734 Art. 39. Sale of Stamps.**—(a) No person other than a collector <sup>3517</sup> of internal revenue or duly authorized deputy collector of internal revenue, assistant treasurer, or designated United States depository shall sell or expose for sale, give away, traffic in, trade, barter, lend, borrow, or exchange any stamps issued pursuant to these regulations: Provided, That any person or corporation which has been duly appointed and constituted and is acting agent of any state for the sale of stock transfer stamps of such state, may upon approval by the Commissioner and upon giving a bond satisfactory to the collector, sell United States stamps issued pursuant to these regulations; Provided further, That a bond shall not be required when such person or corporation uniformly purchases such stamps from the collector for cash. As used in this article, the term “stamps issued pursuant to these regulations” or “stamps to be used under these regulations” shall mean “stock transfer stamps” and “future delivery stamps.”

**3735** (b) No person shall buy, receive, or have in his possession, or under his control, any stamps issued pursuant to these regulations, unless such stamps have been purchased directly from the collector of internal revenue, or duly authorized deputy collector of internal revenue, assistant treasurer, United States designated depository, or a designated agent for the sale of State stock transfer stamps, authorized by the Commissioner, in the district in which the stamps are to be used.

**3736** (c) All requisitions for stamps to be used under these regulations shall be made in writing, on a form prescribed by the Commissioner, to the collector of internal revenue or duly authorized deputy collector of internal revenue, assistant treasurer, or designated United States depository, or State agent authorized by the Commissioner, in the internal-revenue district in which the stamps are to be used, giving the date thereof, the number and denomination of stamps applied for, and the name and address of the purchaser, and shall be signed in ink by the person receiving such stamps.

**3737** (d) If the requisition for such stamps shall be made to any assistant treasurer or United States designated depository or duly authorized state agent for sale of state stock transfer stamps, such assistant treasurer, or United States designated depository, or duly authorized state agent shall keep a record thereof, and on or before the fifteenth day of each month shall file with the collector of internal revenue of the district a statement, for the preceding month, setting forth the number, denomination, and amount of all stamps on hand at the beginning of the month, the number, denomination, and amount sold during the month, and the number, denomination and amount on hand at the end of the month, accompanied with the requisition filed by each purchaser, and on or before the fifteenth day of each month shall pay over to such collector of internal revenue all money received from sales of such stamps for the preceding month, taking his receipt therefor: Provided, that any assistant treasurer or United States designated depository or duly authorized state agent for the sale of state stock transfer stamps who uniformly purchases such stamps for cash shall not be required to keep the record or make the return above prescribed, but the stamps shall be resold only upon requisition as prescribed in paragraph (c), and all requisitions shall be filed with the collector on or before the fifteenth day of each month for the preceding month.



## STAMP TAX REGULATIONS.

**3738** (e) The collector of internal revenue shall keep the requisitions for stamps sold by him and those sold by such assistant treasurer, designated United States depository, or authorized State agent separate and apart from all other requisitions for stamps, and shall preserve them in his office for a period of two years.

## FINES AND PENALTIES.

[¶3502-6, ¶3507-12, and ¶3531.]

**3739** Art. 40. Sections of the Revised Statutes applicable.—The provisions of the internal-revenue laws of the United States, so far as applicable, including sections 3173, 3174, 3175, and 3176 of the Revised Statutes as amended, are applicable to the Revenue Act of 1921. [See ¶4016.]

## DATE EFFECTIVE.

**3740** Art. 41. Date effective.—(a) Issues, sales, or transfers on or after  
3500 December 1, 1917, and prior to April 1, 1919, are subject to tax under the Revenue Act of 1917.

**3740a** (b) Issues, sales, or transfers on or after April 1, 1919, and prior to January 1, 1922, are subject to tax under the Revenue Act of 1918.

**3741** (c) Issues, sales, or transfers on or after January 1, 1922, are subject to tax under the Revenue Act of 1921.

## REDEMPTION OF OR ALLOWANCE FOR STAMPS.

**3741a** Art. 42. Stamps rendered useless, affixed in error, or for which the owner has no use.—Where documentary stamps are rendered useless by gumming or sticking together in transit or otherwise without fault of the purchaser, they may be exchanged by a collector for other stamps of exactly the same quantity and denomination. Amounts paid for stamps used in excess, or on instruments not actually effective and for which a substitute is prepared and stamped, or on instruments not subject to tax or for which the owner has no use, may be refunded, upon claim properly presented to the collector.

**3741b** Art. 43. Claims.—All claims for the redemption of or allowance for stamps must be presented within two years after the purchase of said stamps from the Government. The provisions of sections 3220 to 3228 Revised Statutes do not apply to the redemption of or allowance for internal revenue stamps, and the authority for such redemption or allowance is the act of May 12, 1900 (31 Stats. 177), as amended by the act of June 30, 1902 (32 Stats. 506), set forth below [i. e., as set forth beginning at ¶8024].

## REFUNDS.

[¶8023, ¶8056-8058.]

**3741c** Art. 44. Refunds.—Where taxes are paid pursuant to an assessment and not by the affixing of stamps, claims for the refund of amounts so paid are governed by Sections 3220-3228 R. S. [beginning at ¶8023 herein], as amended, and must be presented within four years next after payment of such taxes, as provided in Section 1316 of the Revenue Act of 1921 [¶8056].

## STAMP TAX REGULATIONS.

## AUTHORITY FOR REGULATIONS.

**3742 Art. 45.** Promulgation of regulations.—In pursuance of the statute the foregoing regulations are hereby made and promulgated and all rulings inconsistent therewith are hereby revoked.

C. P. SMITH,

*Acting Commissioner of Internal Revenue.*

Approved July 8, 1922. [Released for publication July 20, 1922.]

A. W. MELLON, *Secretary of the Treasury.*



## STAMP TAX REGULATIONS.

## REGULATIONS No. 55—1922 EDITION.

(Promulgated June 12, 1922.—Also designated as T. D. 3364.)

Fully indexed on the blue pages at the end of this "Stamp Taxes" division.

## STAMP TAXES ON DOCUMENTS.

(Except on issue, sales and transfers of certificates of stock and sales of products for future delivery [for which see page 709].)

Imposed by

Title XI of the Revenue Act of 1921.

## REGULATIONS—STAMP TAXES.

**3743** Title XI, Revenue Act of 1921, imposing stamp taxes is effective  
3500 on and after January 1, 1922. See section 1100 [§3500].

## BONDS, DEBENTURES, AND CERTIFICATES OF INDEBTEDNESS.

**3744** Article 1. Delivery essential to issue.—Delivery is essential to  
3520 constitute an issue of bonds.

**3745** Art. 2. "Foregoing" defined.—The word "foregoing" in Schedule  
A1 is held to apply to the class of instruments listed therein, regardless of whether issued prior to or after January 1, 1922, and not merely to instruments issued on or after January 1, 1922.

**3746** Art. 3. Bonds accompanying real estate mortgages.—Bonds  
accompanying real estate mortgages are taxable as bonds of indebtedness upon the amount secured.

**3747** Art. 4. Bonds renewed by agreement extending mortgage.—An  
agreement extending a mortgage upon maturity, where a bond is secured by the mortgage and such agreement operates to renew the bond, subjects the latter to stamp tax as a renewal.

**3748** Art. 5. Agreement extending maturity of mortgage bond; additional bond.—An agreement between the holder of a bond and the present owner of a parcel of real estate, extending maturity of a mortgage bond executed by a former owner, operates as a renewal and such renewal is subject to tax. If in addition a new bond is given for the same indebtedness, it also is subject to tax.

**3749** Art. 6. Stamps may be affixed to bonds or indenture; bonds to bear legend.—The necessary revenue stamps may be affixed either to the bonds or to the indenture under which the bonds are issued. If the stamps are affixed to the indenture the bonds must bear a legend showing that the proper revenue stamps have been affixed to the indenture and duly canceled. If the indenture provides for the issue of bonds over a period of years, the necessary stamps may be affixed at the time of each issue.

## STAMP TAX REGULATIONS.

**3750 Art. 7. Interim certificates and temporary bonds.**—Interim certificates or temporary bonds issued in lieu of definitive bonds are taxable, but no additional tax is required upon the issue of the permanent or definitive bonds, which, however, should bear notation of the fact that stamps in the proper amount were duly attached to the interim certificates.

**3751 Art. 8. Instruments issued in numbers, under a trust indenture, are bonds.**—Instruments containing the essential features of a promissory note, but issued in series, secured by a trust indenture, either in registered form or with coupons attached, embodying provisions for acceleration of maturity in the event of any default by the obligor, for optional registration in the case of bearer bonds, for authentication by the trustee, and in some instances for redemption before maturity, or similar provisions, are bonds within the meaning of the statute, whether called bonds, debentures, or notes.

**3752 Art. 9. Scrip-dividend certificates or warrants.**—Scrip-dividend certificates or warrants are taxable as certificates of indebtedness.

**3753 Art. 10. Instrument styled a bond and under seal a bond, unless.**—An instrument which is styled a "bond" and which is under seal should be held subject to tax as a bond unless it is shown affirmatively that it is not a bond.

**3754 Art. 11. Business property investment bond.**—A business property investment bond wherein it is certified that the holder thereof is the owner of an interest in certain specified property, legal title to which has previously been conveyed to a trustee, and whereby the corporation issuing the same agrees to manage the property and distribute the proceeds in a certain manner, is not subject to tax as a bond, debenture, or certificate of indebtedness, but is subject to tax as a certificate of interest in property issued by a corporation.

**3755 Art. 12. Instrument assigning interest in bond.**—An instrument which merely represents an assignment of interest in a bond accompanying a mortgage is not taxable.

**3756 Art. 13. Certificates of deposit; Morris-plan banks.**—Any instrument which is actually a certificate of deposit issued by a bank is exempt from stamp tax, regardless of whether it is negotiable or non-negotiable or whether it is payable on demand or at some specified time. Certificates of deposit issued by banks or organizations operating upon the Morris plan are not subject to stamp tax.

**3757 Art. 14. Certificates of indebtedness.**—(a) The term "certificates of indebtedness" includes only instruments having the general character of investment securities as distinguished from instruments evidencing debts arising in ordinary transactions between individuals. [See ¶4010.]

**3758** (b) Conditional bills of sale used in the sale of merchandise on the installment plan are not certificates of indebtedness within the meaning of Schedule A1 and are not subject to stamp tax unless containing an obligation in the form of a promissory note.



## STAMP TAX REGULATIONS.

**3759 Art. 15. Certificates of indebtedness issued by receivers.**—A certificate of indebtedness issued under order of a Federal court by a receiver is subject to tax.

**3760 Art. 16. Bonds of indebtedness executed and delivered as security.**  
—The tax applies to bonds of indebtedness executed by the obligor and delivered to a bank or trust company as security for the payment of an obligation.

**3761 Art. 17. Bonds executed in Canada and delivered in the United States.**—Bonds executed in Canada by a Canadian corporation, certified to by a trustee in the United States, given for part of the purchase price of timber located in Canada, and delivered in the United States are subject to tax.

**3762 Art. 18. Bonds issued in satisfaction of insurance policies.**—Bonds issued by life insurance companies in satisfaction of insurance policies are subject to tax.

**3763 Art. 19. Bonds issued by school districts.**—Bonds issued by school districts for school purposes are exempt from tax.

**3764 to 3779 Blank.** [No tax on indemnity and surety bonds under the Revenue Act of 1921.]

## STAMP TAX REGULATIONS.

## CAPITAL STOCK, ISSUE.

- 3780** Schedule A 2. (See Regulations No. 40, 1922 Edition, covering this subject [¶3547—Complete table of contents, page 709].)

## SALES AND TRANSFERS OF CERTIFICATES OF STOCK.

- 3781** Schedule A 3. (See Regulations No. 40, 1922 Edition, covering this subject [¶3590—Complete table of contents, page 709].)

## SALES OF PRODUCTS FOR FUTURE DELIVERY.

- 3782** Schedule A 4. (See Regulations No. 40, 1922 Edition, covering this subject [¶3647—Complete table of contents, page 709].)

## DRAFTS, CHECKS, AND PROMISSORY NOTES.

- 3783** Art. 20. Drafts and checks payable otherwise than at sight or on demand.—Drafts and checks payable otherwise than at sight or on demand become subject to stamp tax if delivered or accepted within the United States. [See ¶4004 and ¶4009.]

- 3784** Art. 21. Time draft or check taxable on acceptance or delivery.—A time draft or check becomes subject to tax concurrently with its acceptance or delivery, whichever is prior, within the territorial jurisdiction of the United States, which includes the States, District of Columbia, Hawaii, and Alaska. Time drafts drawn and delivered outside of the United States are subject to the tax upon their acceptance within the United States.

- 3785** Art. 22. Drawee, payee, or indorsee to see that tax is paid.—The drawee, payee, or indorsee should see that the tax is paid before or at the time of acceptance or delivery. The question of who shall pay the tax is a matter for adjustment between the parties.

- 3786** Art. 23. Draft drawn abroad on foreign drawee with foreign payee.—If a draft drawn abroad on a foreign drawee with a foreign payee passes through a bank here in the course of collection, no tax is payable unless it should be delivered by an agent of the drawer to an agent of the payee within the United States.

- 3787** Art. 24. Liability to tax determined by form or face of check or draft.—The liability of drafts or checks to stamp tax as well as the amount of such tax is determined by their form and face and can not be affected by proof of facts or instructions outside of the drafts or checks. A draft expressed to be payable at sight on "arrival of car," or embodying a memorandum to hold until arrival of car, is taxable. A sight draft accompanied by instructions outside the instrument deferring time of payment is not taxable.

- 3788** Art. 25. Draft accepted for payment at future date.—A draft stating no time for payment which is accepted for payment at a certain future date is taxable upon such acceptance as a time draft.

- 3789** Art. 26. Trade acceptances.—So-called "trade acceptances" are taxable in the same manner as ordinary time drafts. [See ¶4005.]



## STAMP TAX REGULATIONS.

**3790** Art. 27. Drafts against actual shipment.—Drafts directly against an actual shipment are taxable in the same manner as other domestic time drafts.

**3791** Art. 28. Time draft covering exports to foreign country.—A time draft directly covering exports to a foreign country and which constitutes an inherent, necessary, and bona fide part of the actual process of exportation is exempt from stamp tax. This exemption does not depend on whether or not the time which the draft has to run will expire before or after the ocean shipment. Time drafts drawn against the proceeds of the foregoing draft are subject to stamp tax. [See ¶4005 and ¶4009.]

**3792** Taxable and nontaxable drafts directly and indirectly involved with exports.—Further reference is made to your letter of August 24, 1920, wherein you request, for the information of the Equitable Trust Company of New York, a ruling as to the application of stamp tax upon transactions connected with the exportation of merchandise in foreign commerce. [See ¶4005.]

**3793** The transactions mentioned by you are as follows:

“(1). The exporter draws a time draft upon the buyer abroad for the sale price of the merchandise and presents this draft, accompanied by the shipping documents, to his bank for discount. It is clear that such a draft is not subject to the stamp tax and it has been so ruled by the Internal Revenue Department.

**3794** “(2). It sometimes happens that the exporter is unable to negotiate a draft drawn by him in the manner above set forth so that he may receive the full value for the same, but he may be able to obtain a loan or advance in some form from his bank, which will take the draft in question for collection. In such case the exporter may give a note to the bank secured by the draft; or, instead of borrowing money from the bank and giving his note therefor, the exporter may draw a second draft payable at a future date upon his bank, payment for which second draft is to be liquidated by the payment of the draft drawn upon the foreign buyer. The question is whether the note or draft given to or drawn upon the bank in the foregoing circumstances is subject to stamp tax.

**3795** “(3). In the event that the note or draft given to or drawn upon the bank, as stated in paragraph (2), is not subject to stamp tax, the question is whether any renewal of such note or drafts given because of the fact that the original draft drawn upon the foreign buyer has not been collected during the period of the original financing is subject to stamp tax.

**3796** “(4). Methods of financing similar to those outlined in paragraph (2) are used in connection with exportations of merchandise where the original documents forwarded abroad are not accompanied by drafts upon the buyers but are either forwarded against sales previously made or on consignment, to be sold either on arrival or perhaps to await better market conditions. The exporter either borrows money from his bank and gives his note or draws his draft upon his bank payable at a future date, with the understanding that the proceeds of the sale of the merchandise are paid in to the collecting bank abroad for the account of the bank making the loan or discounting the draft of the exporter in the United States; such proceeds from time to time to be used in liquidating such loan or advance. The question is whether the note or draft given in connection with such a transaction would be subject to stamp tax.

## STAMP TAX REGULATIONS.

- 3797** “(5). The same question as outlined in paragraph (3) arises in connection with renewals of the note or draft given in connection with the transaction referred to in paragraph (4).”
- 3798** In reply your attention is called to Article [28, §3791] of Regulations 55, a copy of which is inclosed. The exemption extended by that article applies only to time drafts *directly* covering exports to a foreign country and which constitute an inherent, necessary and bona fide part of the actual process of exportation. This exemption does not apply to time drafts drawn against the proceeds of other drafts which are exempted or upon time drafts made against sales previously made or on consignments, to be sold either on arrival or perhaps to await better market conditions.
- 3799** The typical draft which is exempt from the tax as a part of the process of exportation is the one attached to the bill of lading and drawn upon the foreign buyer, which may be discounted and negotiated in this country. The exemption from tax has been held to extend to equivalent drafts drawn upon funds or agencies established in this country by foreign governments or buyers to facilitate exchange. Exemption does not extend to drafts which represent the preliminary or subsequent adjustment or use of accounts or funds involved in exportation.
- 3800** It is, therefore, held by this office that the draft covered by paragraph (1) of your inquiry is not subject to stamp tax.
- 3801** However, the drafts and notes, and this includes renewals, covered by the remaining paragraphs of your letter, cited above, do not directly cover exports to a foreign country and do not constitute an inherent, necessary and bona-fide part of the actual process of exportation and do not come within the exemption extended by Article [28], and are, therefore, subject to stamp tax. (Letter to Murray, Prentice and Howland, New York, N. Y., signed by Commissioner Wm. M. Williams, and dated September 21, 1920.)
- 3802** Art. 29. Time draft to secure purchase money.—A time draft drawn on a domestic bank for the purpose of securing money to purchase goods to be exported is subject to tax regardless of the fact that a contract for the sale of the goods existed at the time the draft is drawn.
- 3803** Art. 30. Time drafts on domestic banks covering exports.—A time draft directly covering a sale for export to a foreign buyer and drawn on a domestic bank as the authorized acceptor of the foreign buyer is exempt from stamp tax. A time draft drawn by or on an exporter or on his bank in payment for export shipments made by the manufacturer on the exporter's order is subject to stamp tax.
- 3804** Art. 31. Time drafts payable in foreign countries.—Time drafts not covering exports drawn and delivered or accepted in the United States and payable in foreign countries are taxable.
- 3805** Art. 32. Time drafts covering shipments to Canal Zone.—Stamp tax attaches to time drafts covering articles shipped from the United States, Hawaii, and Alaska to Canal Zone, if the drafts are delivered within the United States, Hawaii, or Alaska.
- 3806** Art. 33. Time drafts covering shipments to Virgin Islands, Philippines, and Porto Rico.—Stamp tax does not attach to time drafts covering shipments to the Virgin Islands, Philippines, and Porto Rico, because of express legislation exempting shipments to these dependencies.



## STAMP TAX REGULATIONS.

**3807** Art. 34. Time drafts covering shipments from Virgin Islands, Philippines, and Porto Rico.—Time drafts drawn against shipments from the Virgin Islands, the Philippines, and Porto Rico, into the United States, are subject to stamp tax if delivery or acceptance of said drafts first takes place within the United States, Alaska, or Hawaii.

**3808** Art. 35. "Promissory notes."—(a) A promissory note is an unconditional promise in writing made by one person to another, signed by the maker, engaging to pay on demand or at a fixed or determinable future time a sum certain in money to such other person, or to order or to bearer, free from restrictions as to registration or transfer, and usually without coupons.

**3809** (b) The stamp tax on a promissory note is measured by the amount of the principal obligation without regard to the form in which the obligation to pay interest is expressed.

**3810** Art. 36. Notes payable on demand promissory notes.—The term "promissory notes," as used in this Schedule, includes those payable on demand.

**3811** Art. 37. Promissory notes given as security.—Promissory notes given for security only are subject to tax.

**3812** Art. 38. Renewal of promissory note taxable.—Each renewal of a promissory note is taxable. Any writing or instrument however designated which operates as a renewal of a promissory note is taxable. [See ¶4008.]

**3813** Art. 39. Extension or renewal of promissory note by extension of mortgage by which secured.—Where a contract or agreement extending either a chattel or real estate mortgage operates to extend or renew a promissory note secured by the mortgage the renewal of such note is taxable. [See ¶4008.]

**3814** Art. 40. Promissory notes given to Federal land banks and joint-stock land banks.—(a) Promissory notes given to Federal land banks and joint-stock land banks when secured by first mortgages are exempt from stamp tax.

**3815** (b) Promissory notes issued by Federal land banks are exempt from stamp tax.

**3816** (c) Promissory notes issued by joint-stock land banks are subject to stamp tax.

**3817** Art. 41. Promissory notes issued by foreign governments.—Promissory notes issued directly by foreign governments and placed in this country for sale are exempt from stamp tax.

**3818** Art. 42. Promissory notes secured by obligations of the United States.—Promissory notes secured by United States bonds and obligations issued after April 24, 1917, of a par value of not less than the amount of such notes are exempt from tax.

**3819** Food Administration Grain Corporation Notes.—Promissory notes issued by Food Administration Grain Corporation are subject to

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## STAMP TAX REGULATIONS.

stamp tax. (Telegram to The Corporation Trust Company, signed by Commissioner Daniel C. Roper, and dated April 10, 1919.)

**3820 Art. 43. Promissory notes secured by certificates of indebtedness issued by Director General of Railroads or by bonds of the War Finance Corporation.**—Promissory notes secured by certificates of indebtedness issued by the Director General of Railroads are exempt from stamp tax. Promissory notes secured by bonds of the War Finance Corporation are subject to tax.

**3821 Art. 44. Suspension of payment or forbearance.**—Mere suspension of payment or forbearance is not taxable.

**3822 Art. 45. Coupons and interest notes.**—(a) Coupons attached to bonds, debentures, or certificates of indebtedness issued by any individual, partnership, or corporation, or to instruments, however termed, issued by a corporation and known generally as corporate securities (all of which are subject to tax as bonds of indebtedness under Schedule A 1), are not subject to tax if they impose no obligation not imposed by the principal instrument.

**3823 (b)** Interest coupons attached to promissory notes taxable under Schedule A 5, as distinguished from the securities enumerated in paragraph (a), if they are themselves promissory notes, separable from the principal obligation and negotiable independently of it, are subject to tax, even though they impose no obligation not imposed by the principal instrument.

**3824 Art. 46. Payment of interest on demand note not a renewal.**—The mere payment of interest on a demand note without any agreement in writing extending the note, is not a renewal within the meaning of this act.

**3825 Art. 47. Payment of interest in advance after maturity of promissory note a renewal.**—Where after maturity of a promissory note, interest is paid in advance, and as evidence of such payment an indorsement in substance as follows: "19—. Received six months' interest to—, 19— \$—" is made on the note, the indorsement operates as a renewal, and the renewal is subject to tax.

**3826 Art. 48. Policy loan and premium extension agreements.**—Policy loan and premium extension agreements which contain an unqualified promise to pay a specified sum of money at a certain date are subject to stamp tax as promissory notes. Where the sole remedy of payee in case of nonpayment of the premiums or loans is to reduce or cancel the rights of the insured, tax does not accrue.

**3827 Art. 49. Certificates of deposit.**—A certificate of deposit is not subject to tax as a promissory note.

**3828 Art. 50. Post-dated checks.**—Post-dated checks are not subject to tax unless expressly payable after their date.

**3829 Art. 51. Promissory note executed and mailed in Canada.**—A promissory note executed and mailed in Canada to a payee within the United States is not subject to tax.



- 3830 Art. 52. Promissory note executed and mailed to payee in Canada.**  
—A promissory note executed and mailed in the United States to a payee in Canada is subject to tax.

### DEEDS OF CONVEYANCE.

- 3831 Art. 53. Who shall affix stamps.**—The law requires that the person  
3536 who makes, signs, or issues any instrument taxable thereunder shall affix and cancel the revenue stamps. It also prohibits any person from accepting such instruments unless they are properly stamped. The grantee in a deed is liable for the tax as well as the grantor.

- 3832 Art. 54. Actual value at time of conveyance the measure of the tax.**—Where the consideration for a conveyance of lands, tenements, or other real property, is left open, to be fixed by future contingencies, the actual value at the time of conveyance is the measure of the tax upon the deed, instrument, or writing whereby the conveyance is made.

- 3833 Art. 55. Tax, how computed.**—In calculating the amount of stamps which must be affixed to a deed of conveyance, the tax is computed upon the full consideration for the transfer less all encumbrances which rest on the property before the sale and which are not removed by the sale. Encumbrances placed on the property in connection with and as a result of the sale or transfer, as well as notes for deferred payments, can not be deducted in determining the amount upon which tax is calculated.

- 3834 Art. 56. Tax on deed executed by sheriff, referee, or commissioner, how computed.**—The stamp tax on a deed of real property executed by a sheriff, referee, or commissioner to mortgagee, who bids in the property at foreclosure sale to satisfy a mortgage lien, should be computed upon the amount bid for the property plus the cost, if paid by the purchaser.

- 3835 Art. 57. "Sold" defined.**—The term "sold" imports the transfer of the absolute or general title for a valuable consideration or price.

- 3836 Art. 58. Deeds executed and delivered on or after Jan. 1, 1922.**—Deeds executed and delivered on or after January 1, 1922, conveying property in pursuance of a contract made prior to that time are taxable. The same rule applies to similar deeds delivered prior to January 1, 1922, and taxable under the act of 1918 approved February 24, 1919.

- 3837 Art. 59. Deed dated prior to Jan. 1, 1922, but acknowledged and delivered after that date.**—A deed dated prior to January 1, 1922, but delivered subsequent to that date, is taxable under the Revenue Act of 1921. If delivered between December 1, 1917, and April 1, 1919, it is taxable under the act of October 3, 1917. If delivered subsequent to April 1, 1919, and prior to January 1, 1922, it is taxable under the act of 1918, approved February 24, 1919.

- 3838 Art. 60. Deeds in escrow.**—Deeds in escrow become subject to stamp tax upon delivery to the grantee. If delivered between December 1, 1917, and April 1, 1919, they are taxable under the act of October 3, 1917; if delivered on or after April 1, 1919, they are taxable under the act of February 24, 1919; if delivered on or after January 1, 1922, they are taxable under the Act of 1921.

## STAMP TAX REGULATIONS.

**3839 Art. 61. Deeds conveying property sold under foreclosure or execution; tax, how paid.**—Deeds executed by masters in chancery, sheriffs, clerks of courts, etc., to cover transfers of property sold under a foreclosure or execution are subject to tax. The grantee or vendee may be required to pay the tax or the cost of revenue stamps may be included in the expenses of foreclosure sale.

**3840 Art. 62. Deeds on exchange of properties.**—In the case of an exchange of two properties, the deeds transferring title to each are subject to tax, which should in each case be computed on the basis of the actual value of the interest or property conveyed, the amount of any pre-existing lien or encumbrance which is not removed by the sale being deductible.

**3841 Art. 63. What constitutes real property determinable by law of State where located.**—(a) What constitutes "lands, tenements, or other realty" is determinable by the law of the State in which the property is situated. Standing timber is ordinarily held to be real estate, and where so held the deed transferring it is subject to the tax.

**3842 (b)** In States where common-law dower still exists an instrument purporting to convey the inchoate right of dower of a wife or the consummate right of dower of a widow, prior to assignment of dower, is not subject to stamp tax; but an instrument conveying the estate acquired by a widow upon assignment of dower is subject to tax. Where by statute dower has been abolished and a different interest in the husband's real property conferred upon the wife in lieu thereof, the taxability of an instrument purporting to convey such an interest prior to its assignment will be determined by the nature of the wife's interest, and the statutes and decisions of the particular State in which the real estate is located must be consulted.

**3843 Art. 64. Deeds conveying mines.**—Deeds conveying mines are taxable.

**3844 Art. 65. Conveyance of property subject to equity of redemption.**—A conveyance of property subject to an equity of redemption is taxable when made, not when the time for the equity of redemption has expired.

**3845 Art. 66. Conveyance of land in consideration of maintenance.**—A conveyance of land in consideration of life maintenance is taxable, the tax to be measured by the value of the property or interest conveyed.

**3846 Art. 67. Deeds of building and loan associations.**—Deeds of building and loan associations conveying realty are taxable.

**3847 Art. 68. Stock in corporation a valuable consideration.**—Stock in a corporation is a valuable consideration for the transfer of real property.

**3848 Art. 69. Quit-claim deeds.**—A quit-claim deed given for no consideration, or merely the nominal consideration of \$1, for the purpose of correcting a flaw in title is not subject to tax.



## STAMP TAX REGULATIONS.

- 3849 Art. 70. Options and contracts for real estate.**—No tax is imposed upon an option for the purchase of real property or upon a contract for the sale of real estate.
- 3850 Art. 71. Deeds of release and deeds of trust.**—Deeds of release and deeds of trust are exempt from tax under the provisions of this law.
- 3851 Art. 72. Deeds by State, county, or municipal officers.**—Deeds executed by State, county, or municipal officers conveying realty sold for nonpayment of taxes are not subject to stamp tax.
- 3852 Art. 73. Deeds to a State.**—Deeds conveying to a State real estate purchased by it are not subject to tax.
- 3853 Art. 74. Deeds to burial sites.**—Deeds to burial sites which do not convey title to land, but only a right to sepulture, to erect monuments, etc., are not subject to stamp tax.
- 3854 Art. 75. Deed to cover gift.**—A deed issued to cover a pure and bona fide gift of property from husband to wife, or from parent to child, or from an individual to a municipality or other political subdivision, or to the United States, wherein the consideration named is "natural love and affection and \$1," "desire to promote public welfare and \$1," or "\$1 and other valuable considerations" is not taxable.
- 3855 Art. 76. Deed to trustee for benefit of creditor.**—A deed executed by a debtor covering an assignment of property to a trustee to be held for the benefit of a creditor is not subject to tax. When, however, the trustee sells or conveys such property either to the creditor or any other person, the deed executed by him is taxable.
- 3856 Art. 77. Deed to building and loan association.**—A deed transferring title to property to a building and loan association for the purpose of securing a loan on the property so conveyed, which property is immediately reconveyed to its owner, is not subject to tax, the deed of reconveyance being likewise exempt.
- 3857 Art. 78. Deed by husband and wife to "straw man."**—A deed given by a husband and wife to a "straw man" who immediately executes a deed reconveying the property to the wife is not subject to tax if given for no valuable consideration, or merely the nominal consideration of \$1, and, likewise, the deed of reconveyance is exempt.
- 3858 Art. 79. Deeds from agent to principal.**—Deeds from an agent to his principal conveying real estate purchased for and with funds of the principal are not taxable.
- 3859 Art. 80. Reconveyances of partnership property by receivers.**—Conveyances of property of a copartnership, in the hands of receivers, back to the owners after administration of the estate are not taxable.

## STAMP TAX REGULATIONS.

**3860 Art. 81. Partition deeds.**—Partition deeds are not subject to tax unless a consideration passes between the parties by reason of one or more of them taking under the division a share of real estate of greater value than his undivided interest, in which event stamp tax attaches to the deeds conveying such greater shares, calculated upon the value of such consideration.

**3861 Art. 82. Conveyances without consideration.**—Conveyances of realty, not in connection with a sale, to trustees or other persons without consideration are not taxable.

**3862 Art. 83. Conveyances of real estate in foreign country.**—A deed conveying real estate in a foreign country is not subject to tax.

**3863 Art. 84. Deeds confirming title.**—Deeds that are simply confirmatory and do not vest title not already vested are exempt from tax.

**3864 Art. 85. Contracts for sale of real property.**—Contracts for the sale of real property are not taxable unless they vest title.

**3865 Art. 86. Abstracts of title.**—Abstracts of title are not taxable.

**3866 Art. 87. Leases of real property.**—Leases of real property are not subject to the tax.

**3867 Art. 88. Conveyance by coowners in consideration of capital stock.**—A conveyance of real estate by coowners to a corporation organized for convenience in handling the property, made in consideration of the issue to them of the corporation's capital stock, is subject to tax.

**3868 Art. 89. Deeds by executor.**—Deeds by an executor to devisees, conveying specific parcels of real estate, devised to them in common, are not subject to tax unless a consideration passes between the devisees by reason of some of them taking a greater share in the real estate than that to which entitled under the will, in which event tax attaches to the deeds conveying such greater shares, and is calculated upon the amount of value of such consideration.

**3869 Art. 90. Conveyance by corporation to owner of all the capital stock.**—A conveyance of real estate by a corporation without valuable consideration to an owner of all its capital stock in consequence of its dissolution is not subject to tax.

**3870 Art. 91. Conveyance by mortgagor to mortgagee.**—A conveyance by defaulting mortgagor to mortgagee in consideration of the cancellation of mortgage debt is subject to tax calculated on the amount of the mortgage debt plus unpaid accrued interest.

**3871 Art. 92. Conveyances to trustee, or from trustee to cestui qui trust, without consideration.**—Conveyances to a trustee without valuable consideration or from a trustee to a cestui qui trust without valuable consideration are not subject to tax.



## STAMP TAX REGULATIONS.

**3872 Art. 93. Conveyance to United States.**—A conveyance of real estate sold to the United States Government is subject to tax.

**3873 Art. 94. Deed from one corporation to another owning capital stock of former in consideration of payment of debts.**—A deed from a corporation, the entire capital stock of which is owned by another corporation, conveying real estate to the latter in consideration of the payment by the grantee of all obligations of the grantor is subject to tax.

[Conveyance incident to the reorganization of a corporation under the laws of another state, without more.—Read at ¶3567.]

**3874 Art. 95. Judgment or decree of State court transferring title to real estate.**—Judgment or decree of a State court operating to transfer title to real estate is not taxable as a conveyance.

**3875 Art. 96. Taxes and assessments, when deductible.**—Taxes and assessments which have become a lien on real estate by operation of statute and which are not paid at time of sale are deductible from the consideration in computing the stamp tax.

**3876 Art. 97. Conveyance by corporation to an officer through third party.**—Where an officer of a corporation purchases real estate from the corporation, conveyance being first made to a third party and as part of the same transaction, the property is conveyed by the third party to the officer, the conveyance to the third party is subject to tax, while the conveyance from the third party is not subject to tax.

**3877 Validity of unstamped instruments and admission as evidence: Deeds in particular.**—As to the absence of revenue stamps, it is true that the deeds showing title in some of the plaintiffs—they were produced in evidence over the defendant's objection—were without the stamps required by the act of October 22, 1914, c. 331, §22, Schedule A, 38 Stat. 762. But this neither invalidated the deeds nor made them inadmissible as evidence. The relevant provisions of that act, while otherwise following the language of earlier acts, do not contain the words of those acts which made such an instrument invalid and inadmissible as evidence while not properly stamped. Those words were carefully omitted, as will be seen by contrasting §§6, 11, 12 and 13 of the act of 1914 with §§7, 13, 14 and 15 of the act of 1898, c. 448, 30 Stat. 454. From this and a comparison of the acts in other particulars it is apparent that Congress in the later act departed from its prior practice of making such instruments invalid or inadmissible as evidence while remaining unstamped and elected to rely upon other means of enforcing this stamp provision, such as the imposition of money penalties, fines and imprisonment. The decisions upon which the defendant relies arose under the earlier acts and were based upon the presence in them of what studiously was omitted from the later one. (From *Cole et al., vs. Ralph*, 252 U. S. 286.)

## STAMP TAX REGULATIONS.

CUSTOMHOUSE ENTRIES FOR CONSUMPTION  
OR WAREHOUSING.

- 3878** Art. 98. Customhouse entries by United States officials and representatives of foreign countries.—Customhouse entries made by United States officials traveling as such on Government funds are not taxable. Likewise entries made by all representatives of foreign countries in their official capacity are by comity exempt.

WITHDRAWAL ENTRIES FROM CUSTOMS BONDED  
WAREHOUSES.

- 3879** Art. 99. Entries for withdrawal of goods or merchandise.—  
**3538** Entries for withdrawal of any goods or merchandise from customs bonded warehouses are subject to stamp tax.

## PASSAGE TICKETS.

- 3880** Art. 100. Passage tickets issued to Federal and State officials, military and naval forces, and certain foreign representatives.—  
**3539** Passage tickets issued to United States Government officials, employees, military and naval forces, as well as officials of States and their political subdivisions, traveling in the course of their duty as such on vessels operated by private parties or by any government are not taxable when the amount of the passage is paid for by the United States Government, State or political subdivision thereof.

**3881** Ambassadors, ministers, and properly accredited diplomatic representatives of any foreign government to the United States are exempt from the payment of taxes on such passage tickets. As under international law the privileges and immunities of ambassadors and ministers of foreign countries extend to the members of their family and to the members of their household, including attaches, secretaries, and servants, they are likewise exempt from the payment of taxes on such passage tickets. All other foreign agencies not specifically mentioned above are subject to the tax as levied under this schedule.

- 3882** Art. 101. Passage tickets issued to private individuals.—Passage tickets issued to private individuals traveling on vessels operated privately or by any government are taxable.

- 3883** Art. 102. Passage tickets to Porto Rico and Philippine Islands.—Passage tickets to Porto Rico or Philippine Islands are taxable.

- 3884** Art. 103. Passage tickets to Hawaii and Alaska.—Passage tickets issued to Hawaii and Alaska are not taxable.

- 3885** Art. 104. Prepaid orders for passage tickets.—Prepaid orders for passage tickets are not subject to tax.

- 3886** Art. 105. Passage tickets issued on exchange orders purchased in Canada or Mexico.—Passage tickets issued in the United States to ports not in the United States, Canada, or Mexico, on exchange orders purchased in Canada or Mexico, in connection with through transportation from points in Canada or Mexico, are subject to tax.



## STAMP TAX REGULATIONS.

**3887** Art. 106. **Passage tickets to ports not in United States, Canada, or Mexico.**—(a) Passage tickets issued in the United States to ports not within the United States, Canada, or Mexico, on exchange orders purchased other than in the United States, Canada, or Mexico are subject to tax.

**3888** (b) Passage tickets sold or issued in the United States for passage by any vessel to a port or place in Newfoundland are subject to tax.

**3889** Art. 107. **Passage tickets sold in United States from ports not in United States, Canada, or Mexico, to ports not in said countries, not subject to tax, unless.**—Passage tickets sold in the United States from ports not within the United States, Canada, or Mexico, to a port not in the United States, Canada, or Mexico, are not subject to tax unless sold as part of a round trip or through ticket from a port in the United States, Canada, or Mexico.

## PROXIES.

**3890** Art. 108. **Tax on proxies attaches to the instrument.**—The stamp tax on proxies attaches to the instrument and is not measured by the number of grantors and grantees.

**3891** Art. 109. **Stamp may be affixed and canceled by either party to proxy.**—The stamp may be affixed and canceled either by the party who executes the proxy or by the party to whom the proxy is given. [See ¶4021.]

**3892** Art. 110. **Directors of corporations officers.**—Directors of a corporation are officers within the meaning of the clause imposing a tax on proxies for voting at the election for officers of an incorporated company.

**3893** Art. 111. **Proxies to vote stock of building and loan associations.**—Proxies for the purpose of voting the stock of building and loan associations are taxable.

**3894** Art. 112. **Proxies executed and accepted before Jan. 1, 1922.**—Proxies executed and accepted before January 1, 1922, are taxable, under the revenue act approved February 24, 1919.

**3895** Art. 113. **Proxy to vote for officers and for other purposes.**—A proxy for voting at any election for officers of a corporation and authorizing the proxy to act in such capacity upon all questions or matters presented at a stockholders' meeting, is subject to tax of 10 cents only.

**3896** Art. 114. **"Corporation" defined.**—The term "corporation" includes associations, joint stock companies, and insurance companies.

**3897** Art. 115. **Proxies sent out by corporations may be stamped after execution and delivery.**—Where proxies are sent out by a corporation to be executed and returned to the corporation or to the person named in the proxy, such proxies may be stamped after execution and delivery by the person receiving same as the agent of the person executing the proxy. [See ¶4021.]

## STAMP TAX REGULATIONS.

## POWERS OF ATTORNEY.

**3898** Art. 116. Tax on power of attorney, when due.—The tax on a power  
3541 of attorney is due when the instrument is executed and delivered.  
Delivery includes depositing instrument in the mails.

**3899** Art. 117. Tax attaches to the instrument.—Tax is imposed on the  
instrument itself, and is not measured by the number of persons  
joining therein.

**3900** Art. 118. Resolution of board of directors authorizing an officer  
of the corporation to sell, etc., stock or bonds, not taxed as power  
of attorney; otherwise in case of person not an officer.—Where a  
corporation, by resolution of its board of directors, has empowered an  
officer thereof to sell, assign, or transfer stock or bonds standing in the name  
of the corporation, or to perform any act in the name of the corporation,  
such authority is not taxable as a power of attorney for the reason that it  
is necessary for a corporation to perform its corporate acts through one of  
its officers. If, however, a person other than an officer of the corporation  
acting in his official capacity is given this authority, the power of attorney so  
granted is subject to stamp tax.

**3901** Art. 119. Revenue stamp required on each instrument executed  
under general power of attorney granted to person not an officer  
of the corporation.—A general power of attorney granted by a board of  
directors to a person, other than an officer of a corporation acting in his  
official capacity for the purpose of transacting business of the corporation,  
including making conveyances of land and acknowledging deeds, is con-  
sidered specific authority for each such transaction, and a revenue stamp is  
required on each instrument executed under the power of attorney.

**3902** Art. 120. Power of sale embodied in mortgage not taxable.—A  
power of sale embodied in a mortgage, authorizing and empowering  
a mortgagee himself, upon default, to make public sale of the property  
affected and to convey the title to the purchaser at such sale free from all  
rights or equity of redemption, thus avoiding the necessity of resorting to  
the courts for foreclosure, is not taxable.

**3903** Art. 121. Powers of attorney contained in assignments of insurance  
policies.—Powers of attorney contained in assignments, absolute  
or as collateral security, of insurance policies are not subject to tax.

**3904** Art. 122. Powers of attorney from corporations to resident agents.  
—Powers of attorney executed by corporations to resident agents  
authorizing the latter to accept service of process are taxable.

**3905** Art. 123. Power of attorney to sell or transfer Government bonds.—  
A power of attorney to sell or transfer Government bonds is taxable.

**3906** Art. 124. Powers of attorney contained in assignments, for valuable  
consideration, conferring no authority upon assignee not implied  
by the assignment, not taxable.—An assignment, for a valuable considera-  
tion, of debts, wages, mortgages, bonds, etc., ordinarily transfers to the  
assignee all the rights of the assignor and the remedies necessary for their  
enforcement, and the assignee acquires no further rights by the means of a



## STAMP TAX REGULATIONS.

power of attorney clause in the assignment than are conveyed by the instrument itself, and such pro forma power of attorney is therefore not taxable.

**3907 Art. 125. Authority to secretary of corporation to transfer stock on the books not taxable.**—An instrument authorizing the secretary to transfer stock on the books of a corporation is not taxable as a power of attorney, but an instrument appointing an attorney in fact to transfer stock on the books of a corporation is taxable.

**3908 Art. 126. Pro forma power of attorney to transfer bonds or stocks on books of corporation, printed on bond or stock certificate, not taxable.**—The pro forma power of attorney to transfer bonds or stocks on the books of a corporation, embodied in the assignment printed on the back of the bond or stock certificate, is not subject to tax.

**3909 Art. 127. A warrant of attorney in a judgment note or promissory note authorizing confession of judgment.**—The clause in a judgment note or a promissory note authorizing confession of judgment is not taxable as a power of attorney.

**3910 Art. 128. Warrant of attorney in a lease.**—A warrant of attorney embodied in a lease is not taxable.

**3911 Art. 129. Power of attorney mailed in United States to point abroad; power of attorney mailed abroad to party in United States.**—A power of attorney executed and mailed within the United States to a foreign point is subject to tax, but a power executed in a foreign country and mailed there to an agent in the United States is not subject to tax.

**3912 Art. 130. Power of attorney to sell, etc., shares of capital stock, taxable, unless.**—A power of attorney to sell, assign, and transfer shares of capital stock is subject to tax unless it is given in connection with a deposit of the stock as security for a loan.

**3913 Art. 131. Power of attorney authorizing vendee of shares of stock to transfer same.**—A power of attorney by which a person executing the instrument sells, assigns, and transfers shares of stock and appoints the vendee agent for the transfer is not subject to tax.

**3914 Art. 132. Copy of power of attorney, printed on form provided by Government and filed in executive department.**—Where the original power of attorney has been properly stamped and a copy of it is printed on a card (Form 272) provided by the Government, and the card is filed in the executive departments of the Government or with a collector of internal revenue, such copy is not subject to tax.

**3915 Art. 133. Power of attorney authorizing deputy to have access to safe.**—A power of attorney authorizing a deputy to have access only to a safe or safety deposit box is not subject to tax, but a power of attorney to have access and control over its contents is subject to tax.

## STAMP TAX REGULATIONS.

**3916** Art. 134. Power of attorney authorizing Federal officer to assign United States bonds deposited as security.—(a) A power of attorney executed by a bank authorizing a designated officer of a Federal reserve bank to assign United States bonds deposited with the Federal reserve bank and designed to protect it in event of default in payment of a loan is not taxable.

**3917** (b) Powers of attorney given by persons who deposit United States Liberty bonds or other bonds of the United States as security in lieu of surety or sureties on penal bonds under the provisions of Section 1329 of the Revenue Act of 1921 authorizing the official having authority to approve such penal bonds to collect or sell such United States bonds so deposited in case of any default in the performance of any of the conditions or stipulations of such penal bonds, are not subject to the stamp tax.

**3918** Art. 135. Powers of attorney executed and delivered before Jan. 1, 1922.—Powers of attorney executed and delivered before January 1, 1922, are not taxable, even though used subsequent to that date, except such as are taxable under the act approved February 24, 1919.

## PLAYING CARDS.

**3919** (See separate regulations covering this subject.)

3542

**3920 to 3945** Blank.



## STAMP TAX REGULATIONS.

## FOREIGN INSURANCE POLICIES.

**3946** Art. 136. Definitions.—When used in the Regulations under this  
**3545** subdivision—

**3947** (a) The term “insurer” includes any person, copartnership, association, or corporation transacting the business of insurance, and also any agent or broker, wherever applicable.

**3948** (b) The term “insurance” includes every manner of providing indemnity against risks upon property of any description (including rents and profits) from peril by sea or inland waters or in transit on land (including transshipments and storage at termini or way points) or by fire, lightning, tornado, windstorm, bombardment, invasion, insurrection, or riot.

**3949** (c) The term “policy of insurance” includes any instrument by whatever name the same is called whereby insurance is made or renewed by the insurer, as policies, binders, certificates, open policies, covering notes, memoranda, cablegrams or letters.

**3950** (d) The term “other instrument” includes any instrument by which insurance is made or renewed, i. e., by which the relationship of insurer and insured is created or evidenced, whether it be a letter of acceptance, cablegram, or other instrument by whatever name called.

**3951** (e) The expression “whereby insurance is made or renewed” includes any evidence or confirmation of a binding contract of insurance whereby a risk is assumed by the insurer.

**3952** (f) The term “issue” means the act whereby insurance is made or renewed or in any manner becomes a binding contract effective for insurance.

**3953** (g) The term “premium charged” means the total premium payable during the life of a contract of insurance and shall include any additional assessment or charge in the nature of a premium which may be assessed or charged during the life of a contract of insurance, whether payable in one sum or in installments and however paid (and though never paid if the contract of insurance be delivered and accepted or otherwise becomes binding upon the insurer).

**3954** (h) The term “premium” means the agreed price for assuming and carrying the risk. It includes all that is received by the underwriter therefor and is in fact the total consideration receivable for underwriting the risk, whether in one sum or in installments, during the life of the policy.

**3955** (i) The term “United States” includes the States of the United States, the Territories of Alaska and Hawaii, and the District of Columbia.

**3956** Art. 137. Effective date.—Policies of insurance which are issued and accepted on and after April 1, 1919, regardless of when the insurance thereunder becomes effective, are subject to tax, but policies which were issued and accepted prior to April 1, 1919, if issued in the usual course of business and according to general custom and not for the purpose of evading the tax, are not subject to tax.

**3957** Art. 138. Persons liable.—The insurer, the agent, or broker, effecting, accepting, placing, or soliciting the insurance, and also the insured are each liable for the tax.

**3958** Art. 139. What instruments must bear a stamp.—(a) The stamp must be affixed to the first instrument by which the insurance is made or renewed, i. e., by which the relationship of insurer and insured is created or evidenced, whether it be a letter of acceptance, cablegram or other instrument by whatever name called

## STAMP TAX REGULATIONS.

**3959** (b) In the case of so-called "open policies" or "open cargo covers," where the amount of the premium is not definitely determined at time of issuance, the stamps may be affixed to the receipts for monthly or other payments if proper notation be made upon such receipts identifying the original instruments to which they apply.

**3960** (c) In the case of a binder or other instrument whereby insurance is made or renewed, issued without agreement as to the premium to be charged, stamps must be affixed when the amount of the premium is determined.

**3961** Art. 140. Insured to retain policy for two years.—The person having control or possession of a policy of insurance or other instrument to which documentary stamps shall be affixed according to law shall retain such instrument for the period of two years from the date of insurance [sic] thereof for the purpose of enabling internal revenue officers to verify the fact that payment of the full amount of tax due thereon has been made.

**3962** Art. 141. Subsequent instruments shall indicate prior document to which stamps are affixed.—Any policy of insurance or other instrument which is subsequent to or which confirms a contract of insurance that is created or evidenced by any prior instrument by which insurance was originally made or renewed shall bear a notation designating such prior instrument (hereinafter referred to as the original instrument) and showing that the proper stamps have been affixed thereto and canceled. By this is meant that if a letter, cablegram, or other instrument is so worded that it establishes or evidences a contractual relation between the insurer and the insured, executed or executory, by which insurance is made or renewed, or by which the relationship of insurer and insured is created or evidenced, such instrument shall be construed as the original instrument and must have stamps of the proper amount affixed to it, and any policy or other instrument which is subsequent to or which confirms such original instrument must bear thereon the notation above indicated.

**3963** Art. 142. Subsequent instruments that must be stamped.—In case an instrument subsequent to the original instrument provides for the payment of a premium greater than the premium provided for in the original instrument, such subsequent instrument must have affixed thereto stamps equal to the tax imposed upon the additional premium charged therein; also such subsequent instrument must bear notation of the stamps affixed to the original instrument. (See Art. 141.) The same rules apply to any riders, indorsements, or other forms attached to or forming a part of any original or subsequent instrument where such rider, indorsement, or other form provides for the payment of a premium greater than theretofore charged.

**3964** Art. 143. Unstamped instruments and those bearing no notation of stamping.—Failure (a) to stamp the original instrument by which insurance is made or renewed, whether it be a letter of acceptance, cablegram, or other instrument by whatever name called, or (b) to indicate that such original instrument was properly stamped on any policy or other instrument which is subsequent to or which confirms the contract of insurance that is created or evidenced by any prior instrument by which insurance was made or renewed, will be held to raise a presumption of an intent to evade the payment of tax under the provisions of the Act.



## STAMP TAX REGULATIONS.

**3965 Art. 144. Measure of tax.**—The tax is measured by total premium paid, including any additional assessment or charge in the nature of a premium on each policy of insurance or other instrument by which insurance is made or renewed, and is at the rate of 3 cents on each dollar or fractional part thereof of such premium; for example, upon a premium charge of \$10.10 the tax imposed is 33 cents, being 3 cents for each dollar and 3 cents for the fractional part of a dollar.

**3966 Art. 145. Insurance on commodities exported.**—(a) No tax is imposed upon the premium charged for insurance issued to cover commodities which are in the actual process of exportation and which have begun their voyage or preparation for the voyage from the United States.

**3967 (b)** If a policy or other instrument is issued covering both export and non-export property, the tax will be computed upon the full amount of the premium charged, unless such instrument clearly indicates the property for export and the premium charged for the insurance thereon.

**3968 Art. 146. Movable property.**—Movable property, such as rolling stock of railroads, ships, vessels, barges, and other similar movable property, shall be held to be property within the United States if the principal place of business of the corporation or partnership owning and controlling the same is located within the United States, or, in the case of an individual, if he resides in the United States, unless such property is permanently located without the United States for the purpose of ordinary use. The nation of registry of a vessel shall have no bearing upon the location of the property in the same.

**3969 Art. 147. Credits and refunds.**—In case a policy of insurance or other instrument is issued and accepted by the insured, and afterwards, for any reason, such insurance does not become effective, the value of the stamps affixed thereto will be refunded upon a proper claim presented to the collector of internal revenue.

**3970 Art. 148. Penalties.**—In addition to the penalties provided by Sec. 1102 of the Revenue Act of 1921, subdivision 13 of Schedule A imposes a penalty of double the amount of the tax upon (a) any person to or for whom or in whose name any such policy or other instrument is issued, or (b) any solicitor, agent, or broker acting for or on behalf of such person in the procurement of any such policy or other instrument, who fails to affix the proper stamps to such policy or other instrument, with intent to evade the tax.

**3971 Art. 149. Returns.**—No monthly return or monthly statement showing a list of policies or other instruments by which insurance was made or renewed upon property located in the United States by a foreign corporation or partnership or non-resident individual will at this time be required from any person to or for whom or in whose name such policy or other instrument is issued, or from the solicitor or broker acting directly or indirectly for or on behalf of such person, but each person, solicitor, or broker accepting, placing, or soliciting such policy or other instrument shall keep a record of each policy or other instrument subject to the tax imposed by this subdivision by which he has directly or indirectly made, placed, solicited, or assisted in the making, or renewal of, such insurance, or for which he has

## STAMP TAX REGULATIONS.

paid or received compensation, and shall be prepared to furnish full information to the Commissioner at any time upon demand.

## MISCELLANEOUS.

**3972** Art. 150. Stamp affixed and canceled can not lawfully be removed  
3500 and affixed to another instrument.—A stamp affixed to an instrument and cancelled can not lawfully be removed therefrom and affixed to another instrument requiring a stamp. [For refund see beginning at ¶3986.]

**3973** Art. 151. Both parties to taxable instrument liable.—Both parties  
3502 to a taxable instrument are responsible to the Government for affixing and canceling stamps in the required amount. The law does not prohibit parties in interest from entering into an agreement as to which of them shall actually pay same.

**3974** Art. 152. Stamp taxes under revenue act of 1918; present regulations  
3547 generally applicable.—As documentary stamp taxes under the revenue act approved February 24, 1919, were very similar to those imposed under the revenue act of 1921, these regulations are generally applicable to all taxable documents issued and delivered on and after April 1, 1919.

**3975** Art. 153. Schedule A of revenue act of 1921 an extension of schedule A of the revenue act of 1918.—The revenue act of 1921 simply supersedes and extends Schedule A, Title XI, of the act approved February 24, 1919, except in a few instances where the language of the present act slightly modifies or amends that of the former act. These slight changes will be readily noticeable by a comparison of the two acts. Schedule A 2 and 14 of the revenue act of 1918, however, are eliminated.

**3976** Art. 154. Former stamp-tax acts.—For still older acts of Congress requiring stamps to be affixed to certain written instruments, see act of July 1, 1862, schedule B following section 110 (12 Stat., 479); act of March 3, 1863, section 6 (12 Stat., 720); act of June 30, 1864, section 151 (13 Stat., 291); act of March 3, 1865, section 1 (13 Stat., 469); act of July 13, 1866 (14 Stat., 141); act of June 23, 1874, section 1 (18 Stat., pt. 3, 250). The act of June 6, 1872, section 36 (17 Stat., 256), provided for the repeal, on and after October 1, 1872, of stamp taxes on instruments, except the tax of 2 cents on bank checks, drafts, and orders, which was repealed by the act of March 3, 1883 (22 Stat., 488). Taxes were imposed by the act of June 13, 1898, on instruments and documents, under schedule A thereof, and were repealed in part by the act of March 2, 1901, and wholly repealed by the war-revenue repeal act (act of Apr. 12, 1902) (32 Stat., 96), taking effect July 1, 1902. Taxes were imposed by Schedule A of the act of October 22, 1914, upon certain instruments and documents, from December 1, 1914, to December 31, 1915. These taxes were continued in force by the joint resolution of December 17, 1915, until December 31, 1916, but were repealed by the act of September 8, 1916, as of that date. The revenue act of 1917 was in force from December 1, 1917, until March 31, 1919, and the revenue act of 1918 was in force from April 1, 1919, until December 31, 1921.



## STAMP TAX REGULATIONS.

## DENOMINATIONS OF DOCUMENTARY STAMPS.

**3977** Art. 155. Documentary stamps issued.—Under authority conferred  
 3514 upon the Commissioner of Internal Revenue in section 1105 (a) of the Act, the following adhesive stamps have been prepared:

Documentary stamps, Schedule A: One cent, 2 cents, 3 cents, 4 cents, 5 cents, 8 cents, 10 cents, 25 cents, 40 cents, 50 cents, 80 cents, \$1, \$2, \$3, \$5, \$10, \$30, \$60, \$100, \$500, \$1,000.

## PURCHASE OF STAMPS.

**3978** Art. 156. Stamps, where purchased.—The above stamps may be  
 3514 purchased from collectors and stamp deputy collectors of internal revenue.

**3979** Art. 157. Assistant Treasurers of the United States, designated de-  
 3516 positaries, and postmasters to be furnished stamps; bond required.  
 3517 —In addition, provision has been made in the Act for the delivery of stamps by collectors without prepayment to any Assistant Treasurer of the United States, designated depository of the United States, or postmaster, who may be required to give bond for the value of stamps so deposited. It is not mandatory upon the persons named to secure and keep the stamps on sale.

**3980** Art. 158. Stamps on articles manufactured in foreign countries.—  
 Stamps to be affixed to articles manufactured in a foreign country and imported into the United States may be purchased and forwarded to the place of manufacture and there affixed to the articles before the same are packed for importation.

## CANCELLATION OF DOCUMENTARY STAMPS.

**3981** Art. 159. Cancellation of stamps.—In any and all cases where an  
 3514 adhesive stamp shall be used for denoting any tax imposed by Schedule A of the revenue act of 1921, the person using or affixing the same shall write or stamp thereon, or cause to be written or stamped thereon, with ink, the initials of his name and the date (year, month, and day) in which the same shall be attached or used; or shall, by cutting and canceling said stamp with a machine or punch, which will affix the initials and date as aforesaid, so deface the stamp as to render it unfit for reuse. The cancellation by either method should not so deface the stamp as to prevent its denomination and genuineness from being readily determined.

**3982** Art. 160. Additional cancellation required in case of stamps of  
 3513 value of 50 cents or more.—In addition to the foregoing, stamps of the value of 50 cents or more shall have three parallel incisions made by some sharp instrument lengthwise through the stamp after the stamp has been attached to the document; provided, this will not be required where stamps are canceled by perforation.

## STAMPS UNDER FORMER ACTS; POSTAGE STAMPS.

**3983** Art. 161. Documentary stamps only to be used.—Documentary  
 3514 stamps only must be used upon papers, documents, and instruments subject to tax as provided in Schedule A, except as provided in Regulations 40, 1922 Edition, relating to stamp taxes on issue and transfers of stock and sales of products for future delivery.

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## STAMP TAX REGULATIONS.

**3984** Art. 162. Documentary stamps issued under acts of October 22, 1914, October 3, 1917, and February 24, 1919.—Documentary revenue stamps issued under acts of October 22, 1914, October 3, 1917, and February 24, 1919, may be used to pay stamp taxes required by the revenue act of 1921.

**3985** Art. 163. Ordinary postage stamps not to be used for internal-revenue taxes.—Ordinary postage stamps can not be used for the payment of any internal-revenue taxes.

## REDEMPTION OF OR ALLOWANCE FOR STAMPS.

**3986** Art. 164. Stamps rendered useless, affixed in error, or for which the owner has no use.—Where documentary stamps are rendered useless by gumming or sticking together in transit or otherwise without fault of the purchaser, they may be exchanged by a collector for other stamps of exactly the same quantity and denomination. Amounts paid for stamps used in excess, or on instruments not actually effective and for which a substitute is prepared and stamped, or on instruments not subject to tax or for which the owner has no use, may be refunded, upon claim properly presented to the collector.

**3986a** Art. 165. Claims.—All claims for the redemption of or allowance for stamps must be presented within two years after the purchase of said stamps from the Government. The provisions of sections 3220 to 3228 Revised Statutes do not apply to the redemption of or allowance for internal revenue stamps, and the authority for such redemption or allowance is the act of May 12, 1900 (31 Stats. 177), as amended by the act of June 30, 1902 (32 Stats. 506), set forth on page 30 of these regulations [¶8024 herein].

## REFUNDS.

**3986b** Art. 166. Refunds.—Where taxes are paid pursuant to an assessment and not by the affixing of stamps, claims for the refund of amounts so paid are governed by Sections 3220–3228 R. S., as amended [beginning at ¶8023], and must be presented within four years next after payment of such taxes, as provided in Section 1316 of the Revenue Act of 1921 [¶8056 herein].

## AFFIXING STAMPS.

**3987** Art. 167. Two or more stamps may be used, when.—Where a stamp of the proper denomination to pay the tax due on an article or document can not be procured, two or more stamps may be used. In such case as few stamps as possible should be attached and each stamp used should be canceled in the manner provided by regulation.

## DUTIES OF OFFICERS.

**3988** Art. 168. Revenue officers to make investigations.—It is the duty of revenue officers in canvassing for taxes due to investigate as to violations of Title VIII of the act of October 3, 1917, and Title XI of the acts of February 24, 1919, and November 23, 1921, and for this purpose they should visit all State, county, and municipal offices, also banks and trust



companies, having to do with the issuance, handling, or recording of documents taxable under these Titles, as well as customs houses and customs bonded warehouses and steamboat offices and agencies for such information as will lead to the detection of violators of said Titles.

**3989 Art. 169. Revenue agents to report.**—Revenue agents will report to this office all such violations, separate letter reports being made in each case marked "Miscellaneous Division." In each instance the report should show the full amount of delinquent tax discovered.

**3990 Art. 170. Collectors' and deputy collectors' reports of delinquency or additional tax due.**—Form 807 (revised July, 1921) will be used by field deputies in reporting to collectors additional and delinquent miscellaneous taxes discovered, and should be accompanied by returns, offers in compromise, and remittances. In those cases where the tax, penalties, and interest do not accompany the report of the field deputy submitted on Form 807, the collector will prepare and forward to the commissioner a report on Form 807-A (revised July, 1921).

**3991 Art. 171. Stamp tax to be reported for assessment in certain cases.**—Only in cases where instruments are no longer in existence or can not possibly be stamped or where a taxpayer, after being advised of his liability, refuses to affix stamps, will tax be reported for assessment. When assessment is paid a receipt on Form 1 will be issued. In those instances where stamps are purchased and affixed to the instrument receipt on Form 1 will not be issued.

**3992 Art. 172. Regulations covering tax on issue, sales, and transfers of stock and sales of products.**—See separate regulations (No. 40) [page 709] relative to collection of tax on issue, sales, and transfers of stock and on sales of products for future delivery.

#### AUTHORITY FOR REGULATIONS.

**3993 Art. 173. Promulgation of Regulations.**—In pursuance of the statute the foregoing Regulations are hereby made and promulgated, and all rulings inconsistent herewith are hereby revoked.

D. H. BLAIR,

*Commissioner of Internal Revenue.*

Approved June 12, 1922 [Released July 5, 1922].

A. W. MELLON,

*Secretary of the Treasury.*

## MATTERS ADDITIONAL TO THE FORMAL REGULATIONS.

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Forward references are given in place within the formal Regulations 40 and 55, ante, to all of the following rulings, etc., which were in the Service at the date of original issue (January 1, 1923). For Running Table of Contents of stamp tax rulings, etc., issued since January 1, 1923, see yellow Stamp Taxes Supplementary Page 2 which faces the blue Stamp Tax Index.

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**3994** Taxable and tax-free issues upon a merger of corporations.—It appears that paragraph (f) of article 5, which is somewhat uncertain, requires construction in order to be reconciled with paragraph (j) of article 4. The distinction with respect thereto is clearly drawn in Law Opinion 440 and Solicitor's Opinion 4, Income Tax Bulletin 22-20. In case of a consolidation of corporations all stock issued by the consolidated or newly created corporation is subject to tax under paragraph (i) of article 4, and no other provision in the Regulations tends to relieve of the tax by reason of substitution or exchange for the stock of the consolidating corporations.

**3995** It was held in Law Opinion 440, under a provision of the Revenue Act of 1917, substantially the same as the pertinent provision in the Revenue Act of 1918, that stock issued by the merging corporation (continuing corporation) in exchange for stock of the merged corporation is subject to tax as an original issue, saying: "It is an original issue of stock that was never issued before. It is immaterial that part of the new stock of one corporation is issued in exchange for old stock of the other corporation."

**3996** Such rule is considered sound. It is strengthened by the direct language in paragraph (j) of article 4, supra, and by the result reached in case of consolidation of corporations and issue of stock, whether or not in exchange, mentioned supra. Paragraph (f) of article 5, supra, is not necessarily inconsistent therewith.

**3997** It is accordingly concluded that paragraph (f) of article 5 of Regulations 40 (revised) exempts stock of the merging corporation (continuing corporation) from the original issue tax when exchanged for the old certificates of stock of such corporation, but not when exchanged for the old certificates of stock of the merged corporation or corporations. (Office Decision No. 83: Ruling No. 198, March, 1921.)

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(T. D. 3219.)

(273 Fed. 197.)

*(Revenue Act of 1918.)*

A taxable transfer of stock is involved when stock is issued in consideration of the transfer of property and the vendor corporation authorizes the vendee corporation to issue the new stock direct to the vendor's stockholders.

**3998 1. Transfer of right to receive shares or certificates of stock.—**

**3524** Where one corporation sold to another corporation certain property  
**3614** in consideration of the issuance to it of a fixed number of shares of the capital stock of the purchasing corporation, and thereafter, prior to the actual issuance of the stock certificates, the vendor corporation authorized the vendee corporation to issue the shares direct to the stockholders of the vendor corporation, the resolution of the board of directors of the vendor corporation conveying the authority is a transfer of the right to receive such shares, and the transaction is subject to the stamp tax imposed by Subdivision 4, Schedule A, of the Revenue Act of 1918.

**3999 2. Corporations—disregard of corporate entity.—**The substantial difference between a corporation and its stockholders may not be disregarded.

(The decision [syllabus only, as shown above] of the United States District Court, District of New Jersey, rendered May 31, 1921, in the case of Marconi Wireless Telegraph Company of America v. Charles V. Duffy, Collector [273 Fed. 197], is published not as a ruling of the Treasury Department, but for the information of Internal Revenue officers and others concerned.)

**4000 Transfer of stock from trustee to substituted trustee, when such**

**3597** transfer results wholly from operation of law.—Reference is made to your letter of February 3, 1921, wherein you request to be advised "whether when one trustee is substituted for another, the beneficiaries remaining the same, and a certificate of stock is transferred from the name of one trustee to that of the substituted trustee the transfer is subject to tax." ¶In reply, you are advised that this office holds that the transfer of stock from one group of trustees to another group, although one or more of the trustees remains the same, is subject to stamp tax under subdivision (4), Schedule A, Title XI of the Revenue Act of 1918, and that the tax is measured by the face or par value of all the stock covered by the transfer. However, if transfer of title results wholly from operation of law, such transfer is not subject to stamp tax. (Letter to a subscriber, signed by Assistant Commissioner Paul Myer, and dated February, 1921.)

**4001 Transfer of stock to substituted trustee under the Massachusetts**

**3597** law.—Reference is made to your letter of April 22, 1921, with respect to the transfer of stock to the names of succeeding trustees appointed under the Massachusetts statute. ¶In reply you are advised that it is the opinion of this office that where new trustees are appointed under the provis-

ions of Chapter 147, Section 6,\* Revised Laws of Massachusetts, the newly appointed trustees acquire title to the trust estate by virtue of their appointment and without any formal conveyance. Therefore, the transfer of the stock from the names of the retiring trustees to the succeeding trustees is not subject to stamp tax. (Letter to Robert H. Gardiner, Jr., Boston, Mass., signed by Acting Deputy Commissioner A. C. Holden, and dated May 4, 1921.)

\*Section 5. If a trustee under a written instrument declines, resigns, dies or is removed before the objects of the trust are accomplished and such instrument makes no adequate provision for supplying the vacancy, the supreme judicial court, the superior court or the probate court shall, after notice to all persons interested, appoint a new trustee to act solely or jointly with the others as the case may be.

Section 6. A new trustee appointed under the provisions of the preceding section, or appointed in the place of a former trustee in conformity with a written instrument creating a trust, shall, upon giving such bond as may be required, have the same powers, rights and duties and the same title to the estate, whether as a sole or a joint trustee, as if he had been originally appointed; and the court may order any conveyances to be made by the former trustee or his representatives or by the other remaining trustees which it may find proper or convenient to vest the trust estate in the new trustee either solely or jointly with the others.

**4002** Nominal transfer of title to stock on death of trustee to surviving trustee or trustees.—Reference is made to your letter of March 5, 1921, requesting a ruling as to the application of the stamp tax to the transfer of shares of stock to the surviving trustee upon the death of one of the trustees. ¶In reply you are advised that when stock stands in the name of two or more trustees, the nominal transfer of such stock to the surviving trustee or trustees upon the death of one of the trustees is not subject to the stamp tax. (Letter to The Corporation Trust Company, signed by Acting Deputy Commissioner A. C. Holden, and dated March 15, 1921.)

**4003** Use of rubber stamps on certificates in case of transfers of stock to broker for sale and from broker to purchasing customer.—Reference letter AM-CW-636, dated April 15. Permission is granted brokers to use rubber stamp with the name of firm and address in issuing certificates required by Article 13, paragraphs (k) [¶3625], (l) [¶3626] and (m) [¶3627] of Regulations 40 Revised. (Telegram to the Collector of Internal Revenue, New York, N. Y., signed by Acting Deputy Commissioner A. C. Holden, and dated April 19, 1921.)

**4004** Drafts payable in terms of foreign currency, accepted or delivered within the U. S.—Reference is made to your letter of September 7, 1921, requesting a ruling as to the application of the stamp tax to certain drafts drawn outside of the United States where acceptance or delivery is made within the United States but payable in terms of foreign currency; as for example, payable in French francs in New York. ¶In reply you are advised that the stamp tax accrues upon delivery or acceptance within the United States, whichever is prior. This stamp tax should be computed on the rate of exchange at the time and place of such delivery or acceptance. (Letter to the Equitable Trust Company of New York, New York, N. Y., attention Franklin Carter, Jr., signed by Acting Commissioner C. P. Smith, and dated Sept. 20, 1921.)



**4005** Trade acceptance given in settlement of balance due on open export  
 3789 account is not exempt, as it is not incident to the process of ex-  
 3791 portation.—Reference is made to your letter of October 14, 1921,  
 3792 where you state as follows: "A customer of ours has sold and  
 shipped goods to a Cuban firm in Cuba on open account. The Cuban  
 firm, after making a small cash payment, has offered to give its acceptance  
 for the balance due on account of goods shipped." You request to be ad-  
 vised whether this draft is an inherent part of the export transaction, even  
 though it is not accompanied by shipping documents, and therefore exempt  
 from the stamp tax.

**4006** Article 41 of Regulations 55, Revised, provides that "A time draft  
 directly covering exports to a foreign country and which constitutes  
 an inherent, necessary and bona fide part of the actual process of exportation  
 is exempt from stamp tax." This language is not intended to convey the  
 idea that every draft used in payment for exports is exempt from tax by reason  
 of the constitutional prohibition against tax on exports. The drafts which are  
 thus exempt from stamp tax are only those which through long established  
 custom have come to be a necessary part of the process of exportation, of  
 which the draft drawn by an exporter upon a foreign purchaser for the price  
 of the goods and which is accompanied by the bill-of-lading is typical, if not  
 the sole example.

**4007** The acceptance in question is given in settlement of a balance due  
 upon an open account. It is not believed that this instrument is an  
 inherent and necessary part of the actual process of exportation, and, there-  
 fore, no exemption can be allowed on the ground that it constitutes an  
 inherent and necessary part of the process of exportation. (Letter to the  
 National Bank of Commerce in New York, New York, N. Y., signed by  
 Deputy Commissioner F. G. Matson, and dated Nov. 4, 1921.)

**4008** Extension or renewal of promissory note by extension of mortgage  
 3812 by which secured.—Reference is made to your letter of March 23,  
 3813 1921, wherein you state that you have been advised by the office of  
 the Collector of Internal Revenue at Boston, Mass., that "where a  
 mortgage is extended by the usual form of extension, operating to renew the  
 note also, the revenue stamps to be used in that connection should be affixed  
 to such extension agreement rather than to the original note already stamped  
 in accordance with its entire principal amount," and request to be advised  
 whether the foregoing is correct. "In reply you are advised that the ruling  
 referred to above and which you state was given to you by the Collector of  
 Internal Revenue at Boston, Mass., is correct. (Letter to Holmes & Worthen,  
 Boston, Mass., signed by Acting Deputy Commissioner A. C. Holden, and  
 dated March 31, 1921.)

**4009** Drafts covering bunker coal supplied in this country to foreign  
 3783 steamship company.—Reference is made to your letter of April 5,  
 3791 1921, requesting a ruling as to the application of the stamp tax to a  
 draft drawn against a foreign steamship company covering a bill for  
 bunker coal furnished in this country. The sale of bunker coal in this coun-  
 try to a foreign steamship company is held to be a domestic sale and not an  
 export. In view of this fact, a draft drawn on the foreign buyer in payment  
 of such bunker coal is subject to the stamp tax under Schedule A-6, Title  
 XI of the Revenue Act of 1918. (Letter to a subscriber, signed by Acting  
 Commissioner M. F. West, and dated April 13, 1921.)

## STAMP TAX REGULATIONS.

(Decision.)

276 Fed. 51.

Revenue Act of 1918.

(T. D. 3233.)

**Trust Certificates issued under the Pennsylvania Plan held to be taxable as "Certificates of Indebtedness."**

**IN THE DISTRICT COURT OF THE UNITED STATES FOR THE EASTERN DISTRICT OF PENNSYLVANIA.**

Fidelity Trust Company vs. Ephraim Lederer, Collector.	}	December Sessions 1920 No. 8118 Assumpsit.
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**Sur rule for judgment.**

**4010** Dickinson, J.—This case is in effect a case stated, in the determination  
 3520 of which we are asked to decide a question of law. The question  
 3757 broadly stated is whether the "certificates" held by the plaintiff  
 as trustee are taxable. We, in consequence, limit our attention to  
 this.

**4011** The taxing authorities give the impression of their attitude as first  
 one of uncertainty and then one of doubt. We have given the subject  
 of the tax the name of "certificates" in order to get a word as colorless as  
 possible, because any word or words definitely descriptive of what the thing  
 sought to be taxed really is, anticipates the ruling to be made inasmuch as  
 what the thing is determines whether or not it is taxable. It is conceded that  
 Congress might have taxed these "certificates" had they been known or  
 thought of and had Congress so willed. The whole question is has it taxed  
 them? It has if they fall within the verbiage [*sic*] of the Acts of Congress,  
 otherwise they remain untaxed. It is doubtless the fact that the draught of  
 the tax laws had the purpose in mind to tax everything from which income  
 was expected to be derived by granting to one person the use of the money  
 of another. In the effort to make sure of the accomplishment of this purpose  
 resort was had to enumeration and description. The descent from the general  
 to the particular and specific, however careful the attempt to make the list  
 of the latter full and all embracing, always has the result of at least rendering  
 doubtful the inclusion of what is not by name listed. All forms of so called  
 securities or investments issued by corporations, whether expressive of in-  
 debtedness or shares in anything the corporation possesses, are without  
 doubt taxed, as are also all forms of instruments expressive of the indebted-  
 ness of any person to the holder.

**4012** We were strongly impressed by the argument at bar that these two  
 general lines of thought marked the limits of what had been taxes.  
 The question before us then resolved itself into an inquiry into what these  
 "Certificates" are. They are in strictness neither evidences of debt nor of  
 shares in corporate assets. This is because of their peculiar form and of the  
 plan under which created. A dealer in so called investments or securities  
 would without doubt or hesitation list them under the name or designation  
 of "Car Trust Certificates," for such they are. There are many such "on  
 the market." They all have the same general purpose and character. They



are called for because some railroad or other transportation company is in need of rolling stock or other equipment and is without funds or credit with which to supply itself, and there is a legal or other difficulty in the way of a direct pledge of the property. They are issued under a number of different plans. The one with which we are concerned is known as the Philadelphia plan. Those willing to share in the venture are invited to place their contributions in the hands of an acceptable trustee. The rolling stock, or other property is then purchased in the name of this trustee as owner. The trustee then enters into a form of bailment or conditional sale agreement with the carrier, the periodical and final payments upon which are sufficient to pay the interest on the investment and the principal at maturity. The contributors in the meantime hold the certificates or acknowledgment of the trustee of their respective shares in the venture.

**4013** It will thus be seen that in strictness the only obligation in the nature of a debt or promise to pay money is the obligation and agreement of the carrier to pay the agreed price for the hire and use of the property or the rentals as they are commonly termed. The trustee is a mere purse, and only in a secondary sense can be said to owe anything to any one other than faithfulness to its trust obligations, and is not a debtor even in this secondary sense unless and until and as the moneys which belong to the contributors come into its hands. The certificate is not within the literal verbiage [*sic*] of the Act of Congress not being "a certificate of indebtedness issued by any person" nor "an instrument issued by any corporation." If the taxing hand has been laid only upon these specific forms of what are generally known as securities, it must be withdrawn from the "trust certificates" now under view. This would mean that they are the exceptions among this general class of securities and are exempt because of the very effort made in the framing of the law to include all forms of securities of this general character has, in verbal nicety, excluded them. The Act of Congress, however, includes more than the two kinds of securities mentioned above, because we think it includes everything "known generally as corporate securities." That these trust certificates are so known would not be denied. The denial would be of the correctness of this construction of the Act of Congress. There are two obstacles to be surmounted before reading this construction. One is that the rule of the nearest antecedent makes the quoted phrase relate to and serve as a definition of the described kinds of "instruments issued by corporations," and the other is that the finding of a meaning to tax all instruments "commonly known as corporate securities" involves presence of a grammatical error in the Act of Congress. Neither of these obstacles are however insurmountable, if this was the meaning of Congress, and we so find. Nor do we see any conflict between a ruling that these certificates are taxable and the doctrine of the cases to which we have been referred that there is no such thing as a doubtful tax. *U. S. vs. Isham*, 84 U. S., 496.

**4014** The question now presented is admittedly a close one, but this does not necessarily make for the taxpayer. The true doctrine is that neither the Executive nor the Judicial Departments nor both can levy a tax. This can only be done by Congress. When, however, Congress has acted and the tax questioned is found to have been levied, the mere fact that in the light of the particular case in which the question is raised the meaning of Congress might have been more clearly expressed, does not justify refusal to give that meaning effect. The real truth back of the whole discussion is that if these certificates are not taxable, it is because of the accidental circumstance of a wholly nominal separation of the security held

## STAMP TAX REGULATIONS.

by the taxpayer from the obligation of debt entered into by the carrier corporation. The real security is the promise not of one corporation but of two to pay to the certificate holders the sums due them. The real transaction is the request of the carrier company made to the certificate holders to advance the money required for equipment, in consideration of which the carrier agrees to pay back the sum advanced, with interest. This it is true was not the form of the promise, but such it was in substance because it was a promise to pay a sum which was the exact (and not accidental but prefixed) equivalent of the advances, with interest. It is, however, and none the less true, that if for any reason Congress has not included these certificates, no tax can be imposed. The impression to this effect made by the argument at bar has been removed by what seems to us to be the sufficiently expressed will of Congress to tax them.

**4015** We have disposed of the case as if on trial hearing with all the facts which enter into the discussion established, understanding such to be the wish of all parties, it being conceded that all these facts are in the record.

*Rule for judgment discharged.*

**4016** Reliance by original-issue agents, for stamp tax purposes, on state-  
3503 ment of officials of corporation as to "actual value" of its non-par value stock.—Reference is made to your letters of January 3 and

6, 1922, concerning the application of the stamp tax to the issue of stock of no par or face value where such stock is worth less than \$20 per share.

**4017** It is noted that rulings are requested as follows: "May we regard as sufficient authority for tax determination purposes a resolution or instructions from the Board of Directors or the officers of the issuing corporation to the effect that the issued stock is of a certain 'actual value' for stamp tax purposes?"

**4018** In your letter of January 6, 1922, you state "we are the original issue and transfer agents for many corporations and affix revenue stamps for them in the case of original issue of stock." In the absence of further definite information it is assumed for the purposes of this reply that the status of principal and agent correctly describes the legal relationship between you and the corporation for which you act. The responsibility for the correct determination of the actual value of no-par-value stock is upon the taxpayer. Although as a general rule your principal (i. e., the corporation issuing the stock) would be liable for additional taxes and penalties resulting from an incorrect determination of such value, it is absolutely impossible for this office to advise you that in all cases the issue or transfer agent would be free to accept with absolute impunity the resolution or instructions of the proper corporate officials as to the actual value of the stock.

**4019** Original issue tax liability on certificate representing more than one  
[3521 share having actual value of less than \$100.—"We ask also that you advise us as to your interpretation of the no-par-value stock-issue tax provided for by Schedule A (2). Where the actual value 'is less than \$100 per share' is the tax of 1 cent 'on each \$20 of actual value or fraction thereof' on a per share basis, or is it based on the actual value of the certificate which may represent a number of shares?" (Answer.) The stamp tax should be computed on the value of each share. Where the actual value



of a share of no par value stock is \$5 the tax on ten shares of such stock will be 10 cents. (Letter to The Corporation Trust Company, signed by Deputy Commissioner F. G. Matson, and dated January 26, 1922.)

**4020** **Transfer of stock registered in name of a partnership to the individual members thereof.**—Reference is made to your letter of January 14, 1922, wherein you state that a partnership \* \* \* has presented for transfer a certificate of stock for 100 shares of \* \* \* Railway, registered in the name of the partnership, to be split up in the names of the two parties [the two members of the partnership] 50 shares to each, and request to be advised whether said transfer is subject to stamp tax. (Answer) In reply you are advised that this office holds that the transfer of this stock from a partnership to the members of the partnership individually is subject to stamp tax. (Letter to The Equitable Trust Company, New York, N. Y., attention Franklin Carter, Jr., signed by Deputy Commissioner F. G. Matson, and dated February 3, 1922.)

**4021** **Stamps of large denominations in proper aggregate amount may be affixed to permanent corporation record accompanying proxies in lieu of separate stamps to the respective proxies.**—Reference is made to your letter of May 2, 1922, in reply to the letter from this office dated April 26, in regard to the affixing of documentary stamps of large denominations covering the amount of stamp tax incurred under the provisions of section 10, Title XI, of the Revenue Act of 1921.

**4022** In reply you are advised that where the number of proxies required in voting at a stockholders' meeting is sufficiently large to warrant the purchase of stamps of large denominations in payment of the stamp tax on such proxies, the stamps may be affixed to a permanent record of the corporation and signed by the secretary of such corporation, provided the corporate seal is affixed thereto. This permanent record should accompany the proxies for which the stamps were canceled.

**4023** In the event that the special certificate of election mentioned in your letter remains with the proxies in question, such certificate should bear the documentary stamps properly canceled and be retained in the office of the corporation for inspection by the officers of the Bureau of Internal Revenue. (Letter to The Corporation Trust Company, signed by Deputy Commissioner F. G. Matson, and dated May 27, 1922.)

**4024** Transfer of stock standing in name of brokerage firm, and held by  
3595 it for account of its clients, to and into name of successor firm is taxable.—Reference is made to your letter of October 19, 1921, wherein you state that certain shares of Southern Pacific Company's stock stand in the name of Berg, Roesler and Kerr; that said firm has dissolved and a new firm formed under the name of Berg, Eyre and Kerr, and that the new firm desires to transfer to its name the shares standing in the name of the old firm. In connection with this transfer you enclose a copy of a communication received by you and which reads as follows:

"Southern Pacific Railway Company,  
165 Broadway,  
New York, N. Y.

Dear Sirs:

We hereby guarantee that the firm of Berg, Roesler and Kerr have no ownership in any securities presented for transfer registered in their name and that said securities were held by the firm of Berg, Roesler & Kerr for the accounts of their clients and transferred to Berg, Eyre & Kerr under the same conditions as existed with Berg, Roesler & Kerr.

Yours very truly,  
(Signed) Berg, Roesler & Kerr.  
(Signed) Berg, Eyre & Kerr."

**4025** You are advised that the transfer of the stock under the circumstances related is held not to come within the proviso of Sub-division 4, Schedule A, Title XI of the Revenue Act of 1918, which exempts from stamp tax deliveries or transfers to a broker for sale, this provision being construed by the Bureau to apply only to the transfer of certificates of stock from the owner thereof to the broker solely for the purpose of enabling such broker to make a sale thereof for the owner. (See Article 13(k) of Regulations 40, Revised [¶3625.]). The transfer in question is, therefore, held to be subject to stamp tax. (Letter to the Southern Pacific Company, New York, N. Y., signed by Deputy Commissioner F. G. Matson, and dated Nov. 4, 1921.)

**4026** Transfer of stock from banking institution to its nominee is taxable.—  
3595 Reference is made to your letter of August 4, 1922, relative to the application of stamp tax to a transfer of stock from a banking institution to its nominee, accompanied by a certificate that there is no change in the ownership of the stock. ¶In reply you are advised that the transfer tax is not measured by the transfer of ownership of stock but by the transfer of legal title to stock. The term "legal title" as used in the act signifies the appearance of title. See *Bonbright v. State of New York*, 165 App. Div. 640, 151 N. Y. Supp. 35, which case is followed by the Department. You are accordingly advised that the transfer of the stock to the nominee of the bank as referred to by you is subject to stamp tax. (Letter to the Empire Trust Company, New York, N. Y., signed by Deputy Commissioner F. G. Matson, and dated August 16, 1922.)



## STAMP TAX REGULATIONS.

(T. D. 3417.)

**4027** Trust certificates issued under the Pennsylvania Plan held to be taxable as "Certificates of Indebtedness."—Comment: Decision of United States District Court, Eastern District of Pennsylvania, in *Fidelity Trust Company vs. Lederer, Collector*. Sur trial by the court sitting without a jury. After trial Judge Dickinson says: "This case, although in form assumpsit, raises the sole question of the legality of a tax levy. The very question now raised was raised and disposed of on a rule for judgment. Judgment was refused [¶4010]. This necessitated a trial hearing, but the question to be determined has in no wise changed." And in conclusion: "Our conclusion is on the trial what it was on the rule for judgment, that these car-trust certificates are subject to the tax imposed by this act of Congress." (T. D. 3417, Dec. 16, 1922. Reported in full in Internal Revenue Bulletin No. 52 of the 1922 Series, page 15.)

(Decision.)

Revenue Act of 1918.

August 18, 1922.

Installment purchase agreement contracts even though embodying an "agreement to pay" in terms, are not per se promissory notes, and so, are not taxable as such.

UNITED STATES DISTRICT COURT  
NORTHERN DISTRICT OF GEORGIA NORTHERN DIVISION

Haverty Furniture Co.

vs.

United States.

**4028** SAMUEL H. SIBLEY, J.—The tax sought to be recovered was collected under the Revenue Act of 1918, Schedule A6, which lays a stamp tax of 2 cents per \$100 on "drafts or checks \* \* \* promissory notes, except bank notes issued for circulation, and for each renewal of the same." The instruments here involved are claimed to be "promissory notes." They begin with the words, "This agreement witnesseth that I \* \* \* have this day purchased from the Haverty Furniture Co." and conclude with the words, "this writing is the whole contract and no verbal statements or representations are binding." They state at length the description of the furniture bought, the terms and conditions of the sale, including price and time of payment, provide for a retention of title, give an option to the seller to rescind on failure to pay and to appropriate the payments made to rent and depreciation of the furniture, and other agreements. Some of them in stating the price have the words "for which I agree to pay (so much)" others simply "for (so much)."

**4029** The suggestion that the form of contract, with the alteration of it, is an effort to evade the tax may be laid aside. Where one form of instrument is taxed and another not, one may, if he can so satisfactorily transact his affairs, avoid the form that is taxed and use that which is not. This was held in *United States vs. Isham*, 17 Wall. 496. Under the Revenue

## STAMP TAX REGULATIONS.

Act of 1898, which laid a tax upon bank checks, a practice was indulged without censure by which in lieu of a check an untaxed receipt to the bank for so much money as paid to a named person was issued, and taken up by the bank on presentation. If the instruments here are promissory notes they are taxable, otherwise not. As again ruled in *Isham's case*, the taxability of such an instrument is to be determined by its face alone. Outside facts are of no importance. Nor is the practice of the Internal Revenue Department helpful here. No practice appears that decides this question. The regulations and decisions referred to furnish no test, for there is as much difficulty in applying them to the papers here in question as in applying the words of the Act.

**4030** What did Congress mean by the term "promissory notes?" It did not use such broad expressions as "all written evidences of debt," or "all written obligations to pay money." By "promissory notes," used in connection with drafts and checks, was intended commercial paper which generally throughout the United States would be so called and recognized. The exclusion of circulating bank notes illustrates what was thought otherwise to be included. Whether negotiability was contemplated or not, whether an I. O. U. or a due bill is to be included need not now be decided. But there must be an instrument at least whose plain purport is an unconditional and absolute promise to pay a fixed sum to a named or certain person at a fixed time or at sight or on demand, according to commercial usage. This much is included in all the definitions of a promissory note set forth in 7 Cyc. page 532. Instruments which appear on their face to be essentially memorandums of sale, although they evidence an obligation to pay money when the sale shall be consummated, were not intended. Such were dealt with in another portion of the Act, where only those of sales of produce for future delivery on exchanges were taxed. Looking solely to the face of these papers, there is nothing to show that the sale agreed upon therein had been executed by a delivery of the furniture. A suit for the purchase money could not be maintained by merely putting in evidence such a paper. It would have to be supplemented by proof that the seller had on his part delivered the furniture, or tendered delivery. Hence there is here no absolute unconditional promise to pay. Even those forms containing the words "for which I agree to pay" are not such. The meaning is that the buyer agrees to pay on the seller's delivering the furniture. The writings are memorandums of sale which would satisfy the statute of frauds in proving the contract, but they are not promissory notes within the meaning of this statute.

**4031** Judgment is accordingly rendered in favor of the plaintiff against the United States for One Hundred and Fifty-eight and 91/100 Dollars and costs of suit.

**4032** Instances of nontaxable transfers from trustee to substituted trustee of legal title to stock because resulting wholly from operation of law, under the laws of New York.—Reference is made to your inquiry of December 19, 1922, relative to the applicability of stamp tax to the transfer of stock to trustees under conditions outlined therein. The rule laid down in Article 12 (c) Regulations 40 (1922 Edition) and generally applicable is that the transfer of stock to or by trustees is subject to tax. It has been uniformly held by the Department, however, that where a transfer of stock results wholly from operation of law no stamp tax accrues. It was



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provided in Office Decision 127, S. T. 5-21-250,\* that whether or not a given transfer of legal title to stock results wholly from operation of law depends upon the effect given to the particular transaction by the law of the state in which such transaction occurred. Section 270 of the Tax Law of the State of New York (Birdseye's Consol. Laws of N. Y. Vol. VIII, p. 8607) imposes a stock transfer tax identical with that imposed by the Revenue Act of 1921 in so far as the present question is concerned. In construing Section 270 of the New York Tax Law, the following situation was encountered and presented to the Attorney General of that State for a ruling thereon:

"A testator left certain personal property, including shares of stock, in trust to be held by two named trustees, and in case of the death of either the survivor to have the right to nominate a co-trustee to succeed the one deceased. One of the trustees having died, the survivor nominated the Brooklyn Trust Company as successor co-trustee and the latter was duly appointed co-trustee with the survivor by order of the court."

"The stock in question which had stood in the joint names of the two trustees appointed by the will, and upon which stamps had been affixed at the time of the transfer to the trustees from the executors, is about to be surrendered by the surviving trustee for new certificates in the joint names of himself and the Brooklyn Trust Company as co-trustee."

Upon the above stated facts the following decision was made:

"Generally speaking, at least, the word 'transfer' as used in section 270 of the Tax Law has reference to a transaction between living parties and not to cases of devolution of title by death. (Reports of Attorney General 1911, Vol. 2, p. 107; 1912, Vol. 2, p. 211.)

"In cases of this character the title to the stock vests, by operation of law, in the succeeding trustee upon his appointment and there is no transfer within the meaning of section 270 of the Tax Law, but a mere substitution of evidences of title, which is insufficient to subject the transaction to the payment of a tax." Rept. of Attorney General (1912 N. Y.) Vol. 11, p. 352.

The above ruling was subsequently extended by the same authority to apply to the case of where two of three co-trustees resigned and pursuant to the provisions of the will the one remaining trustee appointed a fourth person to serve with him as trustee. Rept. of Attorney General (1914 N. Y.) Vol. 11, p. 345.

**4033** In view of the above mentioned opinions of the Attorney General of New York, you are advised in reply to the questions enumerated in your letter that:

(1) No stamp tax accrues on the transfer of stock from a trustee who has died to a substituted trustee appointed by a New York court to continue the same trust.

(2) No stamp tax accrues where there are two trustees and on the death of one the title is transferred from the deceased trustee to the surviving trustee alone.

(3) No stamp tax accrues where there are two or more trustees and one dies and the court appoints a new trustee to fill the place of the

\*O. D. 127 reads as follows: "Whether or not a given transfer of legal title to shares of stock results wholly from operation of law depends upon the effect given to the particular transaction by the law of the State in which such transaction occurs. If in any case any formal conveyance or act of the parties is necessary in order to vest title in the successor, such transfer is not wholly by operation of law, and is therefore subject to tax."

## STAMP TAX REGULATIONS.

one deceased with no change in the ownership of the surviving trustees; or where a trustee has resigned and a substituted trustee is appointed to continue the trust pursuant to the terms of the will.

The foregoing is applicable only in the case of transfers of stock to trustees appointed under the laws of the State of New York. (Letter to Geller, Rolston and Blanc, New York, N. Y., signed by Commissioner D. H. Blair, and dated January 31, 1923.)

(T. D. 3446.)

**4034** Sales and transfers of stock not subject to tax.—Paragraphs (k) and (l) of Article 13, Regulations 40, 1922 Edition, are hereby amended to read as follows:

**4035** “(k) The mere delivery of a certificate of stock by or on behalf of  
3625 a customer to his broker solely for the purpose of enabling such broker to make a sale thereof for the customer where the broker has no ownership or interest therein, is not subject to stamp tax and does not require an exemption certificate. The transfer of a certificate of stock from the name of the owner thereof to the name of a broker, solely for the purpose of enabling such broker to make a sale thereof for the owner, is not subject to tax, provided the broker shall in every case, at the time of such transfer to him, make and sign a certificate stating that he has no ownership in such stock and that the transfer to him was made solely to enable him to sell the stock for the owner. Such certificate shall in every case be attached to the certificate of stock and presented to the transfer agent at the time such certificate of stock is surrendered for transfer and shall be preserved, together with the old certificate, by such transfer agent, for the inspection of the revenue officer.

**4036** “(l) The mere delivery of a certificate of stock from a broker to his  
3626 customer for whom he has purchased such certificate and when such broker has no ownership or interest therein, is not subject to the stamp tax and does not require an exemption certificate. The transfer of a certificate of stock from the name of a broker to the name of his customer for whom and upon whose order he has purchased such stock, where the tax has been paid upon the transfer of the stock to the broker, is not subject to tax, provided that the broker shall in every case, at the time of such transfer from him, make and sign a certificate stating that the transfer from the broker to his customer is made solely to complete the purchase made by such broker for such customer. Such certificate in every case shall be attached to the certificate of stock and presented to the transfer agent at the time such certificate of stock is surrendered for transfer, and shall be preserved, together with the old certificate, by such transfer agent, for the inspection of the revenue officer.”

**4037** Article 13 of Regulations 40, 1922 Edition, is hereby amended by adding two new paragraphs (o) and (p) reading as follows:

**4038** “(o) A ‘call’ is an agreement to sell and is taxable; but a transfer  
3629 of a certificate of stock pursuant to the ‘call’ is not taxable, being only a fulfillment of the original agreement. The seller shall execute and attach to the certificate of stock his certificate, which shall be accepted by the transfer agent and shall be preserved by him for inspection of the revenue officer. The certificate here prescribed shall be in the following form:



**STAMP TAX REGULATIONS.**

"We hereby certify that the transfer of.....shares of the within stock to.....has been made pursuant to a 'call,' and that the Federal stock transfer stamps for the transaction are affixed to such 'call,' which is in our possession.

.....  
(Seller sign here.)"

**4039** "(p) Where, under Paragraph (k) of this Article, a certificate of  
3629 stock, standing either in the name of the owner or any other person, has been delivered by the owner thereof to a broker for sale, and subsequently, under paragraph (l) of this Article, such certificate has been delivered by a broker to his customer for whom it is purchased and the tax has been paid upon the delivery of such certificate from the seller's broker to the buyer's broker, the transfer of such certificate of stock into the name of the buyer is not subject to tax, provided, that either requisite stamps shall have been affixed to the certificate of stock upon its delivery to the buyer's broker, or the memorandum of sale evidencing the transaction between the seller's broker and the buyer's broker, with the requisite stamps affixed thereto, shall have been attached to such certificate at such time and presented to the transfer agent at the time such certificate is surrendered for transfer. The old certificate, together with the memorandum of sale, if used, shall be preserved by such transfer agent for the inspection of the revenue officer."

(T. D. 3446, signed by Commissioner D. H. Blair, and dated March 1, 1923.)

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(T. D. 3466.)

**4040** **Issues of Stock:** Article 5(g) of Regulations 40, 1922 Edition,  
3582 **Amended.**—Article 5(g) of Regulations 40, 1922 Edition, is hereby amended to read as follows:

"(g) The issue of certificates of stock in exchange for outstanding certificates, for the purpose of splitting up a certificate for a number of shares into two or more certificates for a smaller number of shares of the same kind of stock, where there is no change in ownership or in the total amount of such stock issued, is not subject to tax." (T. D. 3466, signed by Commissioner D. H. Blair, and dated April 13, 1923.)

**4041** **Taxability of instruments entitled "Sale of Oil and Gas Royalty,"**  
3841 **and "Oil and Gas Leases."**—Reference is made to your letter of  
3866 February 28, 1923, with respect to the taxability of instruments entitled "Sale of Oil and Gas Royalty" and "Oil and Gas Lease," copies of which were enclosed.

In the instrument entitled "Sale of Oil and Gas Royalty" the grantor grants, bargains, sells, conveys and sets over to ———, his heirs, successors and assigns an undivided ——— interest in all the oil, gas, coal and other minerals now, or any time hereafter, lying in or under certain described land; also an undivided ——— interest in the grantor's right, title and estate, under and by virtue of an oil and gas mining lease, or other mineral lease, now or hereafter existing upon said land; also the perpetual and irrevocable right, privilege, and easement of entering upon said land and searching for, drilling wells, and taking and carrying away all of the oil, gas, etc., in or under said lands or that may be found therein or thereunder. It contains the usual

## STAMP TAX REGULATIONS.

habendum clause and a warranty of title. It provides that the land described in the conveyance is subject to a certain oil and gas mining lease and that such lease passes to and vests in the grantee. It also expressly declares that it is the true intent and purpose of the conveyance to pass to and vest in the grantee an undivided ——— interest in all the mineral and mineral rights in the land specified to all intents and purposes as if the grantee were the absolute owner of the entire title and estate in that land.

**4042** The instrument entitled "Oil and Gas Lease" is what it purports to be, namely, a lease, and grants merely a right or license to enter and explore for oil and gas and to sever them if found.

**4043** Schedule A-6, Title XI, of the Revenue Act of 1921, provides:

"Conveyances: Deed, instrument, or writing, whereby any lands tenements, or other realty sold shall be granted, assigned, transferred or otherwise conveyed to, or vested in the purchaser or purchasers, or any other person or persons, by his, her, or their direction, when the consideration or value of the interest or property conveyed, exclusive of the value of any lien or encumbrance remaining thereon at the time of sale, exceeds \$100 and does not exceed \$500, 50 cents; and for each additional \$500 or fractional part thereof, 50 cents. This subdivision shall not apply to any instrument or writing given to secure a debt."

**4044** Article 63 (a) of Regulations 55, (1922 Edition) provides in part [¶3841]:

"Art. 63. What constitutes real property determinable by law of State where located.—(a) What constitutes 'lands, tenements, or other realty' is determinable by the law of the State in which the property is situated."

**4045** Section 6590, Revised Laws of Oklahoma, 1910, provides:

"Real property defined. Real or immovable property consists of:

"First. Land.

"Second. That which is affixed to land.

"Third. That which is incidental or appurtenant to land.

"Fourth. That which is immovable by law."

**4046** Section 6591 provides:

"Land defined. Land is the solid material of the earth, whatever may be the ingredients of which it is composed, whether soil, rock or other substance."

**4047** Section 6593 provides in part:

"Appurtenances defined. A thing is deemed to be incidental or appurtenant to land when it is by right used with the land for its benefit, as in the case of a way or water-course, or of a passage for light, air or heat, from or across the land of another."

**4048** Section 6594 provides:

"Personal property defined. Every kind of property that is not real is personal."

**4049** It clearly appears from the above statutes that minerals, including oil and gas, are in the State of Oklahoma a part of the realty while in place in and under land and, as such, are subject to sale and conveyance. (*Rich v. Doneghy* (Okla.), 177 Pac. 86). This also appears to be the law in most jurisdictions. The real question involved is whether a particular instrument relating to oil and gas and other minerals in place operates as a lease or as a conveyance of realty. The provisions of the instrument designated "Sale of Oil and Gas Royalty" show that it was intended to and in fact operates as an absolute conveyance of oil, gas and other minerals in place.



## STAMP TAX REGULATIONS.

(Rich v. Doneghy, supra.) It is accordingly subject to the tax imposed by Schedule A-6, Title XI, of the Revenue Act of 1921. The provisions of the instrument designated "Oil and Gas Lease" clearly show that it was intended to and in fact operates as an oil and gas lease and vests no right to the lessee in the real estate, nor any interest therein or any right thereto, save to explore for oil, etc. (Kelly v. Harris, 162 Pac. 129 (Okla.)). It is, therefore, not subject to the tax imposed by Schedule A-6. See Article 87 of Regulations 55 (1922 Edition) [¶3866]. (Letter to The Corporation Trust Company, signed by Deputy Commissioner F. G. Matson, and dated April 28, 1923.)

(Decision.)

Revenue Act of 1918.

July 5, 1923.

**Car Trust Certificates issued under the Pennsylvania Plan held not to be taxable as "Certificates of Indebtedness."**

IN THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE  
THIRD CIRCUIT

FIDELITY TRUST COMPANY,  
Plaintiff in Error,

vs.  
EPHRAIM LEDERER, Collector of Internal Revenue,  
Defendant in Error,

*In Error to the District Court of the United States for the Eastern District of  
Pennsylvania*

**4050** Before BUFFINGTON and DAVIS, Circuit Judges, and McKEEHAN,  
3520 District Judge. Buffington, Circuit Judge.—This case concerns the  
3757 assessment of a stamp tax on car equipment trust certificates issued  
4010 under what is known as the Philadelphia plan. The government  
4027 assessed and collected such tax, basing its right so to do on the pro-  
vision of the Revenue Act of 1918, quoted in the margin.\* The  
plaintiff, having paid the tax under protest, brought suit against the Col-  
lector to recover the same back, but the Court held it had been properly  
assessed, and entered judgment for the defendant. Thereupon the plaintiff  
sued out this writ, and the question involved is whether the equipment  
trust certificates here concerned fall within the purview of the statute as  
being "Certificates of Indebtedness \* \* \* issued by any corporation  
with interest coupons \* \* \* known generally as corporate securities."  
**4051** Turning to that question, we note that the certificate issued by the

\*"1. Bonds of Indebtedness: On all bonds, debentures or certificates of indebtedness issued by any person, and all instruments, however, termed, issued by any corporation with interest coupons or in registered form known generally as corporate securities, on each one hundred dollars of face value or fraction thereof five cents: provided, that every renewal of the foregoing shall be taxed as a new issue: Provided further, That when a bond conditioned for the repayment or payment of money is given in a penal sum greater than the debt secured, the tax shall be based upon the amount secured."

## STAMP TAX REGULATIONS.

plaintiff, a copy of which is printed in the margin† does not evidence, or certify to, any indebtedness owing by the plaintiff to the bearer, nor is it the coupon contract usually accompanying corporate securities, to pay periodic interest indebtedness. On the contrary, it is simply a certificate of the right of its holder to participate in a rental payable under a certain lease which lease restricts the right of the certificate holder to payment solely "from and out of the deferred rentals when paid as provided for in a lease of 500 steel cars made by Fidelity Trust Company, Trustee, to Interstate Railroad Company, bearing date the 2nd day of February, 1920, which rentals are payable to the Trustee for the benefit of the holders of this and other certificates amounting at par to \$900,000, to which lease and the agreement hereinbefore mentioned reference is made for a statement of the rights of the holders of such certificates." These certificates are issued under what is known as the Philadelphia plan, which was devised many years ago to provide for such a legal bailment of railroad equipment as would allow railroads to hold possession and use property owned by third parties. The legal method of financing such transactions was subscription to a fund—in this case, \$900,000—which was handled by a trustee company and used to buy railroad equipment—in this case 500 steel cars—which were then leased to a railroad—in this case, the Interstate Railroad Company—at an annual rentals, the car meanwhile being marked "Fidelity Trust Company, Trustee, owner and lessor."

**4052** It will thus be seen that when the transaction is viewed as a whole, as must be the case, and the certificate in question measured from that standpoint, no indebtedness is involved or obligation incurred by the trustee to the holder, but it is simply a certificate of the holder's right to proportionate participation in a rental when paid.

**4053** Car trust certificates such as here involved, have been so long and so largely used in the financial world and are so vital a factor in the financing and equipment of railroads, that it would seem that Congress, had it intended taxing them, would have so covered them by a specific designation or by proper generic description, as to leave no question of its intent.

**4054** In our judgment, the law and facts are with the plaintiff and the judgment of the District Court [¶4010 and ¶4027] is therefore reversed and the cause remanded to said Court for further procedure in accordance with this opinion.

†"Due to the bearer hereof on the 1st day of APRIL, 1923, on surrender hereof at the office of Fidelity Trust Company, Philadelphia, the sum of Thirty.....00/100 Dollars (\$30.00) in United States Gold Coin, being the semi-annual dividend on Certificate No. .... of Interstate Railroad Equipment Trust Series C, payable only out of the rentals under the Lease referred to in the said Certificates.

Fidelity Trust Company, Trustee,

By ..... THOMAS J. BROWN, Treasurer."



(T. D. 3503.)

**4055 Memorandum for sales not required to show price per share at**  
 3631 **which stock is sold.—Article 15 of Regulations 40 (1922 Edition)**  
**amended.**—Article 15 of Regulations 40 (1922 Edition) is hereby  
 amended to read as follows:

“Art. 15. Memorandum for sales.—Every person who makes an agreement to sell or transfer title to shares of stock by delivery of certificates assigned in blank, shall as a part of such transaction promptly make and deliver to the buyer a bill or memorandum of such sale or agreement to sell, duly signed by the seller or his agent, to which the requisite stamps shall be affixed and cancelled, which bill or memorandum shall show the date of the transaction, the names of the seller and buyer and the name and number of shares of stock,\* and the tax paid thereon, and in the case of a transaction made on an exchange shall bear a number upon the face thereof and have printed and written in ink thereon the words “Subject to the Revenue Act of 1921 and regulations made in accordance therewith.” No more than one such bill or memorandum made by the seller on any given date shall bear the same number: *Provided, however,* That no single transaction or purchase or sale that is made upon an exchange by one member to another member shall require to be evidenced by more than one stamped memorandum of sale or agreement to sell.” (T. D. 3503, signed by Acting Commissioner, C. R. Nash, and dated August 2, 1923.)

\*Omitting “and the price per share.”

**4056 The form and face of the stock certificate determines the rate of**  
 3591 **transfer tax where stock is sold after an amendment of the issuing**  
**corporation's charter authorizing the exchange of new par value**  
**stock for existing no par value stock.**—Consideration has been given your letter of April 16, 1923, objecting to the ruling of this Bureau, dated April 7, 1923, relative to the payment of stamp tax upon transfers of stock of the — Company in cases where the certificates transferred are, upon their face, of no par value though sold after an amendment of the Company's charter which authorizes the issuance of shares of the par value of \$10 in exchange for an equal number of shares of no par value.

**4057** This Bureau cannot concede the correctness of your position that the tax imposed under Schedule A-3, Title XI, of the Revenue Act of 1921 [¶3523], is not a tax upon the stock certificate but is a tax upon the transfer of title and that because of that fact the value of the shares as shown by the amended certificate of incorporation—not the face of the stock certificate—should control in determining the amount of the tax.

**4058** Since under the specific language of section 1100 [¶3500], the tax is to be paid “for and in respect of the certificates of stock \* \* \* and other documents or for or in respect of the vellum, parchment, or paper upon which such instruments are written \* \* \* or printed” it is apparent that the tax is intended as a tax on the documents themselves. It is true the tax provided in Schedule A-3 [¶3523] is contingent upon the sale, agreement to sell, etc., shares or certificates of stock, but upon the performance of the acts described the tax attaches to the paper which evidences the transaction. The amount of the tax is to be computed, as specified in Schedule

## STAMP TAX REGULATIONS.

A-3 on each \$100 of face value, or where such shares are without par or face value it is to be computed on each share involved in the transaction.

**4059** The construction of the law above set forth is supported by the cases of *Malley v. Bowditch*, 259 Fed. 809; *Edwards v. Wabash R. R. Co.*, 264 Fed. 610; *U. S. v. Isham*, 17 Wall. 496. In the case of *Edwards v. Wabash R. R. Co.*, above cited, the court had under consideration the provisions of a section of the Revenue Act of 1917 which was in substantially the same language as section 1100 of the Act of 1921, also a section of Schedule A of the Act of 1917 imposing a tax on the original issue of certificates of stock upon the organization or reorganization of a company. In the course of its opinion the court said:—"This the defendant contends is a tax imposed on documents rather than on the transaction of which they may be a part. 'Stamps are imposed, not on transactions, but on documents.' And our attention is called to a case, *Malley v. Bowditch*, 259 Fed. 809, decided at the October term, 1918, by the Circuit Court of Appeals in the First Circuit, in which the court is said to have used this language: 'We are called upon to apply a statute imposing stamp taxes on documents of a certain class, and which assumes that these documents may be issued, not only by corporations, but by associations and companies.' \* \* \* The tax is not a franchise tax or a corporation tax, but a stamp tax or document tax.' We see no reason or doubting the accuracy of the above statement. We certainly have no intention of denying the proposition."

**4060** In the opinion of this Bureau this language though applied to a section of the Act relating to the issuance of certificates of stock applies with equal force to the section relating to the *transfer* of certificates of stock.

**4061** In view of the language of the Act itself and in view of the decisions above cited this Bureau cannot depart from the well settled rule laid down in the case of *U. S. v. Isham*, above cited, that, "The liability of an instrument to a stamp duty, *as well as the amount of such duty* is determined by the form and face of the instrument and cannot be affected by proof of facts outside of the instrument itself." This Bureau therefore must adhere to its former ruling that the transfer tax liability should be computed on shares of no par value at the rate of 2 cents per share and that on shares which show the change to a par value of \$10 the tax should be computed at the rate of 2 cents for each \$100 of par value of fraction thereof. (Extracts from a letter to a subscriber, signed by Deputy Commissioner, F. G. Matson, and dated May 23, 1923.)



## STAMP TAX REGULATIONS.

(Decision.)

**4062** The issue of four \$25 shares in exchange for each outstanding  
 3561 \$100 share (otherwise of the same kind) and the subsequent issue  
 of a share of no par value stock in exchange for each \$25 share, all  
 pursuant to amendments of the issuing corporation's charter increasing  
 the number of shares but not the amount of its capital, held not subject to  
 original issue tax.—[Comment: In *West Virginia Pulp & Paper Company*  
*vs. Bowers*, Collector (U. S. District Court—New York, Southern District,  
 August 1, 1923), the plaintiff sought to recover stamp taxes paid under  
 protest on that which the Collector termed original issues of stock on reor-  
 ganization, and thereupon taxed as such pursuant to the provisions of Article  
 4 (h), Regulations 40 [Par. 3561], and which consisted of the exchange of  
 4 shares of new \$25 par value common stock for each share of outstanding  
 \$100 par value common stock, otherwise of the same kind, in accordance  
 with an amendment of the plaintiff's charter increasing the number of shares  
 from 200,000 to 800,000 without change in the amount of its capital which  
 remained \$20,000,000, and the subsequent exchange of one share of no par  
 value stock for each share of \$25 par value stock pursuant to further amend-  
 ment of the corporation's charter.—The Corporation Trust Company.]

*Memorandum Opinion.—Knox, J.:* In a case such as this there is little  
 use for a court of first instance to enter upon a discussion of its views as to the  
 interpretation to be placed upon a particular taxing statute. Any decision  
 of mine will be but a conduit through which a more authoritative ruling will  
 be had, and for such reason I forbear to elaborate upon my conclusions.  
 It is enough to say that in my judgment the acts of plaintiff giving rise to the  
 assessment of the tax in question are not within the purview of the statute  
 upon which defendant relies. What plaintiff did, in my opinion, is not to be  
 regarded as an original issuance of stock, either upon organization or reorgan-  
 ization. No essential change in the capital with which plaintiff does business  
 has taken place, and the rights of its stockholders have been neither increased  
 nor lessened. They continue to hold their respective portions of the original  
 issue of stock save that such portions are now evidenced by an increased  
 number of pieces of paper, and these they may have without their corpora-  
 tion being subjected to the tax assessed against it. Defendant's motion for  
 judgment of dismissal is denied and unless defendant desires to litigate the  
 allegations of fact set up in the complaint there is no reason why plaintiff  
 should not have judgment for the sum sued for.

## STAMP TAX REGULATIONS.

(Decision.)

July 24, 1923.

The prorata issue, under amendment to charter, of a number of shares of reduced par value in exchange for each share outstanding, and aggregating the par value thereof, without change of character in the stock and without increasing the total capitalization held not to be subject to tax as original issue on reorganization.

IN THE DISTRICT COURT OF THE UNITED STATES, SOUTHERN DISTRICT OF OHIO, WESTERN DIVISION

The American Laundry Machinery Company, a corporation organized and existing under the laws of the State of Ohio,  
*Plaintiff,* No. 3259

vs.

Charles M. Dean, United States Collector of Internal Revenue for the First District of Ohio, *Defendant.*

The Procter & Gamble Company, a corporation organized and existing under the laws of the State of Ohio, *Plaintiff,*  
vs. No. 3244

Charles M. Dean, United States Collector of Internal Revenue for the First District of Ohio, *Defendant.*

Ruling of court on demurrer to Plaintiff's petition.

For plaintiffs: Dinsmore, Shohl and Sawyer, Cincinnati, Ohio.

**4063** Hickenlooper, District Judge (orally): These petitions are filed by the several plaintiffs for recovery of taxes paid under Section 1100, Schedule A, Paragraph 2, of the Revenue Act of 1921 (42 Stat. 227, 301, 303), and Section 1100, Schedule A, Paragraph 3, of the Act of February 24, 1919, commonly known as the Revenue Act of 1918. The language of both sections is identical, and by both it is provided that there shall be "levied, collected and paid, for and in respect of \* \* \* certificates of stock \* \* \* or for or in respect of the vellum, parchment, or paper upon which such instruments \* \* \* are written or printed \* \* \* the several taxes specified in such schedule." Schedule A, Paragraph 2, provides for the above mentioned stamp tax "on each original issue, whether on organization or reorganization, of certificates of stock \* \* \* by any corporation, on each \$100 of face value or fraction thereof, 5 cents."

**4064** In order to facilitate dealing in the stock of the plaintiff corporations and the acquisition and wider distribution of such stock by and among employees, customers, and the public in general, amendments to the articles of incorporation were secured whereby the par value of the outstanding and issued capital stock was reduced in amount, and holders of stock of the original \$100 par value shares were given the right to, and did, transfer or convert such shares into the larger number of shares of reduced par value. Neither the aggregate par value of any holder nor the aggregate par value of all stockholders was increased, nor was the type of stock changed in other respect than in the number of shares outstanding. In other words, before the amendment the common capital stock of the Procter & Gamble Company consisted of \$19,714,000 divided into 197,140 shares of the par value of \$100 each,



while after the amendment had become effective such common capital stock still continued as the sum of \$19,714,000 divided into 985,700 shares of the par value of \$20 each, and each holder of one share of the par value of \$100 each had received in lieu of his certificate therefor a certificate for five shares of \$20 par value each. The defendant contends that these newly-issued certificates are subject to tax under the laws above quoted.

**4065** There is no question that the taxes provided by the revenue acts in question are documentary stamp taxes. *Malley, Collector, v. Bowditch, et al.*, 259 Fed. 809; *Edwards v. Wabash Ry. Co.*, 264 Fed. 610. But, unlike the stamp tax upon promissory notes, the provisions of the law are not applicable to all certificates of stock, but by their express terms pertain only to certificates of "original issue." The question is not whether the certificates themselves are original, but whether the issue is original.

**4066** The defendant contends that in passing upon this point the court is constrained to look only to the certificates themselves, and to determine whether any certificates identical in kind had heretofore been issued and outstanding, citing *United States v. Isham*, 17 Wall. 496. Were the question whether the certificates were in fact certificates of stock, or debentures, or some other type of instrument, the citation would be applicable, but since the court is of the opinion that the criterion must be the originality of the issue, inquiry must extend beyond the certificates themselves. An original issue of capital stock involves the idea of a change in the amount or kind of stock outstanding. Capital stock of corporations may be divided into several well-known classes. We thus find, among the recognized corporate issues, common stock, preferred stock of various classes, issues, and priorities, and the more recent and somewhat unique no-par value stock. We are not at this time prepared to say that a change from par value common stock to no-par value common stock would not constitute a change in the kind of capital stock outstanding just as much as a change of common stock to a preferred stock, and *vice versa*, would constitute such change in kind, but we are firmly of the opinion that no original issue of stock can exist without either a change in the amount of such stock outstanding or in the kind or character of such stock.

**4067** Counsel for the plaintiff alleges that the criterion should be whether a corporation has assumed different obligations towards its several stockholders, or whether the stockholders have secured different "ultimate rights" against the corporation. This might be made the criterion were the change in the kind or character of the stock outstanding, but will not apply if the change be in amount of capital stock outstanding. No change of obligation upon the part of the corporation, or of ultimate right on the part of the stockholders, exist after the issuance of stock as a stock dividend, but there can be no question but that stock issued by way of dividend is an original issue and subject to tax.

**4068** The court places no reliance whatever upon the language of the law "whether on organization or reorganization." These are not words of limitation, restricting the operation of the tax to the cases of original organization or reorganization of corporations, but are simply declaratory of the application of the law to cases of original organization and reorganization, as well as cases of all other original issues. As above stated, therefore, the question resolves itself into whether the present issues are original issues in the sense this phrase is used in the statute.

**4069** The defendant contends that the new smaller par value shares cannot be a substitution for the shares turned in, of larger par value, because

of the excess in number of the former over the latter. In the opinion of the court this argument is specious in that the law makes the par value of the stock the foundation of the tax, and not the number of shares. If the number of shares of the same par value were increased, and old certificates were exchangeable for new certificates for a greater number of shares, but each of the same par value, the point would be well taken, and no objection could be successfully urged against the taxation upon the additional number of shares so issued. In such a case there would be a change in the amount of such stock outstanding. In the present case, however, there is no change in the par value of the common stock outstanding after the exchange and before. Nor is there any change in the rights and privileges, either in sharing in the earnings or participating in the management, as to any stockholder before and after he has exchanged his stock. The right to cast four or five votes, where the stockholder previously had the right to cast but one, in no way changes the proportionate voting power of the stockholder or his proportionate interest in the assets and earnings of the corporation."

**4070** We are clearly of the opinion that before any issue of capital stock can be designated an "original issue" some stock must pass from the treasury of the corporation into the hands of a stockholder which either differs as to kind, class, or privileges from stock which had theretofore been outstanding, or which increases the aggregate par value of some previously outstanding class of stock. The change of kind, class, or privileges referred to must be a change in substance and in fact, and not a mere change in name or form. In the instant case there was, in the opinion of the court, no change in the amount of the common capital stock outstanding. In each case this remained identically the same, as is already illustrated by the Procter & Gamble Company case cited above. There the aggregate par value of the common stock outstanding was the sum of \$19,714,000 both before and after all shares had been exchanged for the lower par value. Nor was there any real change in the privileges attached to stock ownership. Certainly, the kind or character of the stock was not changed, being common stock both before and after the transaction. Nor was the transaction a reorganization of the corporation in the sense in which that word is used in the statute. Reorganization, as there used, contemplates the surrender of the old stock and the receipt of either stock in a new corporation or stock of a different kind or class in the old corporation.

**4071** Not only do the several federal revenue acts predicate the tax upon the par value of the issue, thus recognizing capital stock as consisting of a definite monetary figure, but the general corporation laws of Ohio so define and fix the meaning of capital stock. Such capital stock consists of a definite, named amount of money, and the par value thereof, or the number of shares into which this fund is divided, is a collateral incident. In our opinion the increase in the number of shares, with a corresponding reduction in the par value of each, involves no change in either the amount or kind of stock of the plaintiff companies, issued and outstanding, and cannot be considered as an original issue.

The demurrers must, therefore, be overruled.



## STAMP TAX REGULATIONS.

(Decision.)

September 22, 1923.

The issue of four shares of \$25 par value for each outstanding share of \$100 par value, pursuant to charter amendment reducing par value of shares, is not subject to tax as original issue on reorganization.

DISTRICT COURT FOR THE NORTHERN DISTRICT OF OHIO  
EASTERN DIVISION

The Trumbull Steel Company, Plaintiff,

vs.

C. F. Routzahn, Collector of Internal Revenue, Defendant.

**4072** WESTENHAVER, District Judge:—The sole question presented is  
3561 what issues of stock by a corporation are subject to the stamp tax  
4062 imposed by Secs. 1100 and 1107, Schedule A, Par. 2, War Revenue  
4063 Act approved Nov. 23, 1921, (42 Stat. 227, 301, 303; Supplement  
1923 U. S. Comp. Stat. Sec. 6318i, 6318p, Schedule A, Par. 2).

**4073** Prior to August 16, 1920, The Trumbull Steel Company had issued  
and outstanding, 131,681 shares of stock evidenced by certificates  
of par value of \$100 each. On that date, pursuant to Secs. 8719-8722 G. C.  
of Ohio, the company amended its articles of incorporation, changing the  
par value of each share of \$100 to \$25. The outstanding certificates were  
thereafter called in and four new certificates for each of the old were issued.  
No other change in stock ownership or stock privileges or corporate organiza-  
tion was made. A tax of five cents on each \$100 par value of the new certi-  
ficates was levied and assessed, paid under protest, and application for a refund  
made to the Commissioner of Internal Revenue, and by him refused. Hence  
this action.

**4074** Secs. 1100 and 1107, Revenue Act of 1921 are precisely the same as the  
corresponding sections of War Revenue Act of 1918 approved Feb. 24,  
1919 (40 Stat. 1057, 1133, 1135). In all provisions pertinent to this contro-  
versy, these two revenue acts are precisely the same as the War Revenue  
Act of 1917 approved Oct. 3, 1917, (40 Stat. 300, 319, 321) and, as was pointed  
out in *Edwards v. Wabash Ry. Co.* (2 C. C. A.) 264 Fed. 610, the provisions  
of the War Revenue Act of 1917 were substantially the same, so far as they  
pertain to this subject matter, as corresponding provisions in the Spanish  
War Revenue Act approved June 13, 1898 (30 Stat. 458) and of the Emergency  
War Revenue Act approved Oct. 22, 1914 (38 Stat. 753). This being true,  
a construction given to the provisions of the War Revenue Act of 1917 or  
of the two other revenue acts referred to prior to the re-enactment of the same  
provisions in the Revenue Act of 1921, is controlling, upon the familiar  
rule that the re-enactment by Congress without change of a statute which has  
previously received a certain construction, whether judicial or departmental,  
is an adoption by Congress of such construction. *Sewing Machine Companies*  
*Case*, 18 Wall. 553, 584; *Kepner v. United States*, 195 U. S. 100, 121; *United*  
*States v. G. Falk & Bro.*, 204 U. S. 143, 152; *United States v. Cerecedo*  
*Hermanos y Compania*, 209 U. S. 337, 339.

**4075** The Act in question imposed a stamp tax of five cents on each \$100  
of face value or fraction thereof of capital stock. The language  
describing the same is "on each original issue, whether on organization or  
reorganization, of certificates of stock \* \* \* by any corporation."

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## STAMP TAX REGULATIONS.

Transfers, sales, or reissue of certificates are subject to a different tax and are provided for in other paragraphs of Sec. 1107. Hence the question is, what is an original issue of certificates? Or, differently stated, what is an original issue on reorganization?

**4076** These questions were fully considered in *Edwards v. Wabash Ry. Co. supra*. It arose under War Revenue Act of 1917 and was decided Feb. 8, 1920. The Wabash Ry. Co. had outstanding two classes of preferred stock and also common stock. It called in one class of preferred stock and converted it part into preferred and part into common and issued new certificates to the holders thereof, conferring new and different rights and privileges in the corporate property and management. It was held that this readjustment of the stock of the corporation was not an original issue either on organization or reorganization, and that the new certificates were not subject to the documentary stamp imposed by the War Revenue Act of 1917. This readjustment of corporate rights and privileges among stockholders was more fundamental and more worthy to be called a reorganization of the corporation than the changes effected by the plaintiff herein among its stockholders. In the former case the rights and privileges of the stockholders were, as between themselves, and in the assets of the corporation, substantially changed and readjusted, whereas in the present case no change was effected but each stockholder at the end of the process had merely four certificates evidencing precisely the same rights and privileges as were previously evidenced by a single certificate.

**4077** Upon the principle and authorities above stated, this case is controlling. It is pointed out in the opinion that the provisions of the Spanish War Revenue Act imposing a stamp tax on stock certificates was given a departmental construction excluding therefrom re-issues where there was no change of ownership but merely a substitution in the hands of the same stockholder of certificates for one class of stock in lieu of certificates for another class (T. D. 20694, Feb. 7, 1899); and also that a like departmental construction had been given to the corresponding provisions of the Emergency War Revenue Act of 1914 (T. D. 2051, March 9, 1914); and that this departmental construction thus declared and acquiesced in was not changed until 1918 (T. D. 2752, Aug. 14, 1918). It was held that the re-enactment of the same language in the War Revenue Act of 1917 after this departmental construction had been established, was the equivalent of an adoption by Congress of that construction. In addition thereto we now have the re-enactment by Congress of the exact language of the War Revenue Act of 1917 after a judicial construction to the same effect.

**4078** In view of these considerations, whatever doubt might originally or otherwise exist as to the provision in question, *Edwards v. Wabash Ry. Co.* should be followed. Nothing in the way of original discussion can be profitably added to the carefully considered opinion of Circuit Judge Rogers. The conclusion now reached accords with the holding of District Judge Hickenlooper, Southern District of Ohio, July 24, 1923, in *American Laundry Mach. Co. v. Dean* [¶4063, herein], and of District Judge Knox, August 1, 1923, in *West Virginia Pulp & Paper Co. v. Bowers* [¶4062, herein]. Such also seems to be the purport of *Holmes Federal Taxes*, 1923 Edition, pp. 1392-4.

**4079** What is a reorganization of a corporation such as makes new certificates as original issue subject to the stamp tax, need not be further considered. Cook on Corporations, 6th Ed., Sec. 883, attempts a definition



## STAMP TAX REGULATIONS.

of a corporate reorganization. Obviously, that part of this definition which might be taken as classifying as a reorganization a mere adjustment of stock among stockholders, is excluded by *Edwards v. Wabash Ry. Co.*, and the reenactment by Congress of the same provisions without change of language after this construction was declared.

*Defendant's demurrer is overruled. An exception is noted.*

**4080** *Lederer vs. Fidelity Trust Company.*—[The United States Supreme  
**4050** Court, on October 22, 1923, granted the petition for a writ of certiorari  
 in this case (§4050). (Docket No. 582, October Term, 1923.)—  
 The Corporation Trust Company.]

(T. D. 3526.)

*(Changed completely, in effect.)*

**4081** Returns by persons engaged in the business of buying, selling or  
 3636 transferring shares of stock. Article 17 of Regulations No. 40 (1922  
 Edition) amended.—Article 17 of Regulations No. 40 (1922 Edition)  
 [§3636] is hereby amended to read as follows:

**4082** "Art. 17. Returns by persons making sales.—(a) All persons who  
 are wholly or partly engaged in the business of buying, selling or  
 transferring shares of stock, whether such sales, purchases or transfers shall  
 be made, cleared, settled, or adjusted through a clearing house, or otherwise,  
 shall on or before the fifteenth day of each month, and at any other time  
 designated by the Commissioner, render under oath a true return (Form 838,  
 Revised 1923) for the preceding month or for any other period designated by  
 the Commissioner. This return should be made to the collector of internal  
 revenue for the district in which such person or persons are located, and should  
 contain in detail the following data and information:

- (1) The month for which the return is made.
- (2) The name and address of the person, partnership, corporation, or  
 association making the return.
- (3) The value of stamps on hand on the first day of the month.
- (4) The value of stamps purchased during the month.
- (5) The value of stamps used during the month.
- (6) Balance of stamps on hand at end of month.

**4083** (b) This return is required to be filed for each month even though  
 no transactions occurred during the month." (T. D. 3526, signed by  
 Commissioner D. H. Blair, and dated October 23, 1923.)

## STAMP TAX REGULATIONS.

(T. D. 3530.)

**4084.** Bonds of indebtedness and certificates of indebtedness under the 1918 Act.—Court decision.—The decision of the United States District Court for the Southern District of Illinois in the case of Danville Building Association, A Corporation, v. John L. Pickering, Collector, the syllabus of which appears below [¶4085 to ¶4087] is published not as a ruling of the Treasury Department, but for the information of internal revenue officers and others concerned.

[The syllabus referred to in ¶4084 above, follows.]

**4085** 1. *Bonds of Indebtedness—Scope of Title XI, Section 1100, Revenue Act of 1918 (Subdivision 1, Schedule A).*—Title XI, Section 1100, of the Revenue Act of 1918 (Subdivision 1, Schedule A), lays a documentary stamp tax upon an instrument in writing, under seal, conditioned for the repayment of money borrowed and obligating the borrower to do certain things under penalty of forfeiture and foreclosure, regardless of whether the seal is necessary or unnecessary, regardless of whether the instrument is called by some other name than a bond of indebtedness, and regardless of whether it is negotiable or assignable or non-negotiable and non-assignable.

**4086** 2. *Bonds of Indebtedness—Taxability Determined by the Face of the Instrument.*—Under Title XI, Section 1100, of the Revenue Act of 1918 (Subdivision 1, Schedule A) the taxability of an instrument is determined by looking to its form and substance, and not particularly to its operation. Denominating a writing as a "contract" does not serve to exempt it from the tax if it is apparent from its face and substance that it is a taxable instrument.

**4087** 3. *Certificate of Indebtedness—Negotiability and Assignability.*—Title XI, Section 1100 of the Revenue Act of 1918 (Subdivision 1, Schedule A), taxing certificates of indebtedness, makes no exception in favor of such certificates as are non-negotiable and non-assignable and have none of the attributes of investment securities. (T. D. 3530, signed by Acting Commissioner C. R. Nash, and dated November 10, 1923.—Bull. II (23)-33, p. 13.)



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CALENDAR FOR EXCISE TAXES.

AND

GUIDE TO EXCISE TAXES REGULATIONS.

(See other side.)

### CALENDAR FOR EXCISE TAXES.

**Returns:** Monthly on or before the last day of the month, each month's return to cover the transactions of the preceding month.

**Tax:** Monthly at the time of filing the return, (or before the last day of the month).

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# EXCISE TAXES

BEING TITLE IX OF THE REVENUE ACT OF 1921.

## TITLE IX.—Excise Taxes.

[Articles Sold or Leased by the Manufacturer or Importer.]

[Tax based on price for which article is sold or leased.]

**4500 Sec. 900.** That from and after January 1, 1922, there shall be levied, assessed, collected, and paid upon the following articles sold or leased by the manufacturer, producer, or importer, a tax equivalent to the following percentages of the price for which so sold or leased—

**4501** (1) Automobile trucks and automobile wagons (including tires, inner tubes, parts, and accessories therefor, sold on or in connection therewith or with the sale thereof), 3 per centum;

**4502** (2) Other automobiles and motor cycles (including tires, inner tubes, parts, and accessories therefor, sold on or in connection therewith or with the sale thereof), except tractors, 5 per centum;

**4503** (3) Tires, inner tubes, parts, or accessories for any of the articles enumerated in subdivision (1) or (2), sold to any person other than a manufacturer or producer of any of the articles enumerated in subdivision (1) or (2), 5 per centum;

**4504** (4) Cameras, weighing not more than 100 pounds, and lenses for such cameras, 10 per centum;

**4505** (5) Photographic films and plates (other than moving-picture films), 5 per centum;

**4506** (6) Candy, 3 per centum;

**4507** (7) Firearms, shells, and cartridges, except those sold for the use of the United States, any State, Territory, or possession of the United States, any political subdivision thereof, or the District of Columbia, 10 per centum;

**4508** (8) Hunting and bowie knives, 10 per centum;

**4509** (9) Dirk knives, daggers, sword canes, stiletos, and brass or metallic knuckles, 100 per centum;

**4510** (10) Cigar or cigarette holders and pipes, composed wholly or in part of meerschaum or amber, humidors, and smoking stands, 10 per centum;

**4511** (11) Automatic slot-device vending machines, 5 per centum, and automatic slot-device weighing machines, 10 per centum; if the manufacturer, producer, or importer of any such machine operates it for profit,

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## EXCISE TAXES LAW.

he shall pay a tax in respect to each such machine put into operation equivalent to 5 per centum of its fair market value in the case of a vending machine, and 10 per centum of its fair market value in the case of a weighing machine;

**4512** (12) Liveries and livery boots and hats, 10 per centum;

**4513** (13) Hunting and shooting garments and riding habits, 10 per centum;

**4514** (14) Yachts and motor boats not designed for trade, fishing, or national defense; and pleasure boats and pleasure canoes if sold for more than \$100, 10 per centum.

**4515** If any manufacturer, producer, or importer of any of the articles enumerated in this section customarily sells such articles both at wholesale and at retail, the tax in the case of any article sold by him at retail shall be computed on the price for which like articles are sold by him at wholesale.

**4516** The taxes imposed by this section shall, in the case of any article in respect to which a corresponding tax is imposed by section 900 of the Revenue Act of 1918, be in lieu of such tax.

**[Selling or Leasing Articles at Less Than Fair Market Price.]**

**4517** **Sec. 901.** That if any person who manufactures, produces or imports any article enumerated in section 900, or leases or licenses for exhibition any positive motion-picture film containing a picture ready for projection, (a) sells, leases, or licenses such article to a corporation affiliated with such person within the meaning of section 240 of this Act [§1074 herein], at less than the fair market price obtainable therefor, the tax thereon shall be computed on the basis of the price at which such article is sold, leased or licensed by such affiliated corporation; and (b) if any such person sells, leases, or licenses such article whether through any agreement, arrangement, or understanding, or otherwise, at less than the fair market price obtainable therefor, either (1) in such manner as directly or indirectly to benefit such person or any person directly or indirectly interested in the business of such person, or (2) with intent to cause such benefit, the amount for which such article is sold, leased or licensed shall be taken to be the amount which would have been received from the sale, lease or license of such article if sold, leased or licensed at the fair market price.

**[Works of Art.]**

**4518** **Sec. 902.** That there shall be levied, assessed, collected, and paid upon sculpture, paintings, statuary, art porcelains, and bronzes, sold by any person other than the artist, a tax equivalent to 5 per centum of the price for which so sold. This section shall not apply to the sale of any such article (1) to an educational institution or public art museum, or (2) by any dealer in such articles to another dealer in such articles for resale.



## [Returns and Payments of Taxes.]

**4519 Sec. 903.** That every person liable for any tax imposed by section 900, 902, or 904, shall make monthly returns under oath in duplicate and pay the taxes imposed by such sections to the collector for the district in which is located the principal place of business. Such returns shall contain such information and be made at such times and in such manner as the Commissioner, with the approval of the Secretary, may by regulations prescribe.

**4520** The tax shall, without assessment by the Commissioner or notice from the collector, be due and payable to the collector at the time so fixed for filing the return. If the tax is not paid when due, there shall be added as part of the tax a penalty of 5 per centum, together with interest at the rate of 1 per centum for each full month, from the time when the tax became due.

## [Articles Sold or Leased by the Manufacturer or Importer.]

[Tax based on so much of the amount for which sold or leased as exceeds a specified price.]

**4521 Sec. 904.** That from and after January 1, 1922, there shall be levied, assessed, collected, and paid, in lieu of the taxes imposed by section 904 of the Revenue Act of 1918, upon the following articles sold or leased by the manufacturer, producer, or importer, a tax equivalent to 5 per centum of so much of the price for which so sold or leased as is in excess of the price hereinafter specified as to each such article—

**4522** (1) Carpets and rugs, including fiber, on the amount in excess of \$4.50 per square yard in the case of carpets and \$6 per square yard in the case of rugs;

**4523** (2) Trunks, on the amount in excess of \$35 each;

**4524** (3) Valises, traveling bags, suit cases, hat boxes used by travelers, and fitted toilet cases, on the amount in excess of \$25 each;

**4525** (4) Purses, pocketbooks, shopping and hand bags, on the amount in excess of \$5 each;

**4526** (5) Portable lighting fixtures, including lamps of all kinds and lamp shades, on the amount in excess of \$10 each;

**4527** (6) Fans, on the amount in excess of \$1 each.

## [Consumption Tax on Jewelry Sold by Dealers.]

**4528 Sec. 905.** (a) That on and after January 1, 1922, there shall be levied, assessed, collected, and paid (in lieu of the tax imposed by section 905 of the Revenue Act of 1918) upon all articles commonly or commercially known as jewelry, whether real or imitation; pearls, precious and semiprecious stones, and imitations thereof; articles made of, or ornamented, mounted or fitted with, precious metals or imitations thereof, or ivory (not

including surgical instruments, eyeglasses, and spectacles); watches; clocks; opera glasses; lorgnettes; marine glasses; field glasses; and binoculars; upon any of the above when sold by or for a dealer or his estate for consumption or use, a tax equivalent to 5 per centum of the price for which so sold.

**[Consumption Tax on Jewelry to be Paid by Vendor.]**

**4529** (b) Every person selling any of the articles enumerated in this section shall make returns under oath in duplicate (monthly or quarterly as the Commissioner, with the approval of the Secretary, may prescribe) and pay the taxes imposed in respect to such articles by this section to the collector for the district in which is located the principal place of business. Such returns shall contain such information and be made at such times and in such manner as the Commissioner, with the approval of the Secretary, may by regulations prescribe.

**4530** (c) The tax shall, without assessment by the Commissioner or notice from the collector, be due and payable to the collector at the time so fixed for filing the return. If the tax is not paid when due, there shall be added as part of the tax a penalty of 5 per centum, together with interest at the rate of 1 per centum for each full month, from the time when the tax became due.

**[Bona Fide Prior Contracts Made.]**

**4531** **Sec. 906.** (a) That if (1) any person has, prior to August 15, 1921, made a bona fide contract with a dealer for the sale or lease, after the tax takes effect, of any article in respect to which a tax is imposed by section 900 or 904, or by this subdivision, and in respect to which no corresponding tax was imposed by section 900 of the Revenue Act of 1918, and (2) such contract does not permit the adding, to the amount to be paid thereunder, of the whole of the tax imposed by section 900 or 904 of this Act or by this subdivision; then the vendee or lessee shall, in lieu of the vendor or lessor, pay so much of the tax imposed by section 900 or 904 of this Act or by this subdivision as is not so permitted to be added to the contract price. If a contract of the character above described was made with any person other than a dealer, no tax shall be collected under this Act.

**4532** (b) If (1) any person has, prior to August 15, 1921, made a bona fide contract with any other person for the sale or lease, after the tax takes effect, of any article in respect to which a tax is imposed by section 900 of this Act, and in respect to which a corresponding but greater tax was imposed by section 900 of the Revenue Act of 1918, (2) the contract price includes the amount of the tax imposed by section 900 of the Revenue Act of 1918, and (3) such contract does not permit the deduction, from the amount to be paid thereunder, of the whole of the difference between the corresponding tax imposed by section 900 of the Revenue Act of 1918 and the tax imposed by section 900 of this Act; then the vendor or lessor shall refund to the vendee or lessee so much of the amount of such difference as is not so permitted to be deducted from the contract price.



**4533** (c) If (1) any person has, prior to August 15, 1921, made a bona fide contract with any other person for the sale or lease, after December 31, 1921, of any article in respect to which a tax was imposed by section 900 of the Revenue Act of 1918, and in respect to which no corresponding tax is imposed by section 900 of this Act, (2) the contract price includes the amount of the tax imposed by section 900 of the Revenue Act of 1918, and (3) such contract does not permit deduction, from the amount to be paid thereunder, of the tax imposed by section 900 of the Revenue Act of 1918; then the vendor or lessor shall refund to the vendee or lessee so much of the amount of such tax as is not so permitted to be deducted from the contract price.

[Method of Handling Taxes Payable by Vendee.]

**4534** (d) The taxes payable by the vendee or lessee under subdivision (a), shall be paid to the vendor or lessor at the time the sale or lease is consummated, and collected, returned, and paid to the United States by such vendor or lessor in the same manner and subject to the same penalties and interest as provided by section 903.

**4535** (e) Any refund by the vendor or lessor under subdivision (b) or (c) shall be made at the time the sale or lease is consummated. Upon the failure of the vendor or lessor so to refund, he shall be liable to the vendee or lessee for damages in the amount of three times the amount of such refund, and the court shall include in any judgment in favor of the vendee or lessee in any suit for the recovery of such damages, costs of the suit and a reasonable attorney's fee to be fixed by the court.

[The Term "Dealer" Defined.]

**4536** (f) A vendee who purchases any article with intent to use it in the manufacture or production of another article intended for sale shall be included in the term "dealer," as used in this section.

[Frauds on Purchasers.]

**4537** Sec. 1326 [of Title XIII of the Revenue Act of 1921]. That whoever in connection with the sale or lease, or offer for sale or lease, of any article, or for the purpose of making such sale or lease, makes any statement, written or oral, (1) intended or calculated to lead any person to believe that any part of the price at which such article is sold or leased, or offered for sale or lease, consists of a tax imposed under the authority of the United States, or (2) ascribing a particular part of such price to a tax imposed under the authority of the United States, knowing that such statement is false or that the tax is not so great as the portion of such price ascribed to such tax, shall be guilty of a misdemeanor and upon conviction thereof shall be punished by a fine of not more than \$1,000 or by imprisonment not exceeding one year, or both.

[Export Sales.]

**4538** Sec. 1305 [of Title XIII of the Revenue Act of 1921]. That under such rules and regulations as the Commissioner with the approval of the Secretary may prescribe, the taxes imposed under the provisions of

Titles VI, VII or IX shall not apply in respect to articles sold or leased for export and in due course so exported. Under such rules and regulations the amount of any internal-revenue tax erroneously or illegally collected in respect to exported articles may be refunded to the exporter of the article, instead of to the manufacturer, if the manufacturer waives any claim for the amount so to be refunded.

**[Articles Purchased from and Sold to Virgin Islands.]**

**4539 Sec. 1304** [of Title XIII of the Revenue Act of 1918, which section has not been repealed]. That there shall be levied, collected, and paid in the United States, upon articles coming into the United States from the Virgin Islands, a tax equal to the internal-revenue tax imposed in the United States upon like articles of domestic manufacture; such articles shipped from such islands to the United States shall be exempt from the payment of any tax imposed by the internal-revenue laws of such islands: Provided, That there shall be levied, collected, and paid in such islands, upon articles imported from the United States, a tax equal to the internal-revenue tax imposed in such islands upon like articles there manufactured; and such articles going into such islands from the United States shall be exempt from payment of any tax imposed by the internal-revenue laws of the United States.

**[Overpayments and Overcollections.]**

[See Section 1304, Revenue Act of 1921, at ¶8018 herein.]

**[Special Methods for Collecting Certain Taxes.]**

[See Section 1301, Revenue Act of 1921, at ¶8012 herein.]

**[General Penalty Provisions.]**

[See law provisions beginning at ¶8014 herein.]

**[General Administrative Provisions.]**

[Read under "Miscellaneous Matters" at the back of the book.]



## EXCISE TAXES REGULATIONS.

UNITED STATES INTERNAL REVENUE  
Form 728—Revised Sept., 1922

## MANUFACTURER'S EXCISE TAXES

(Title IX, Sections 900 and 904,  
Revenue Act of 1921)

CHARACTER OF TAX	RATE	TAX DUE	CHARACTER OF TAX	RATE	TAX DUE	AMOUNT OF TAX
<b>SECTION 900:</b>			<b>SECTION 904:</b>			
(1) Automobiles, trucks, wagons, etc.	3%	\$.....	(12) Litteria, etc.	10%	\$.....	Total tax..... \$.....
(2) Automobiles, motor cycles, etc.	5%	.....	(13) Hunting garments, etc.	10%	.....	Less overpayment for month of..... 192.....
(3) Tires, parts, etc.	5%	.....	(14) Yachts, motor boats, etc.	10%	.....	Total amount of tax due.....
(4) Cameras and lenses	10%	.....				Penalty 25%.....
(5) Photographic films and plates	5%	.....				Penalty 5%.....
(6) Candy	3%	.....	(1) Carpets and rugs	5% of costs	(See par. 1 reverse side.)	Interest.....
(7) Firearms, shells, etc.	10%	.....	(2) Trunks	5% of costs	(See par. 2 reverse side.)	Total amount due..... \$.....
(8) Hunting and sports knives	10%	.....	(3) Valises, suit cases, etc.	5% of costs	(See par. 2 reverse side.)	
(9) Dirk knives, daggers, etc.	10%	.....	(4) Purse, pocketbooks, etc.	5% of costs	(See par. 2 reverse side.)	
(10) Cigar holders, etc.	10%	.....	(5) Portable lighting fixtures	5% of costs	(See par. 2 reverse side.)	
(11) Automatic sewing machines	5%	.....	(6) Fans	5% of costs	(See par. 2 reverse side.)	
Automatic washing machines	10%	.....				

I swear (or affirm) that the foregoing is a true return of the amount of tax due in respect to the above-mentioned articles for the month of ..... 192, and that the amount deducted for overpayment is allowable by law. Sworn to and subscribed before me this ..... day of ..... 192

(Name) or (Witness) (See paragraph 4 on back) (Title) or (Witness)

Signed

(State whether individual owner of business, member of firm, or if owner of corporation or duly authorized manager or agent, give title.)

Return with remittance should be sent to the Collector of Internal Revenue for your district and not to the Commissioner of Internal Revenue at Washington, D. C. (See instructions, par. 4, on reverse of this form.) If you have nothing to report, make notation to that effect on this form and return to the Collector of Internal Revenue.

2-11535

ORIGINAL RETURN—This form must be returned to the Collector of Internal Revenue

UNITED STATES INTERNAL REVENUE  
Form 728—Revised Sept., 1922

## MANUFACTURER'S EXCISE TAXES

(Title IX, Sections 900 and 904,  
Revenue Act of 1921)

CHARACTER OF TAX	RATE	TAX DUE	CHARACTER OF TAX	RATE	TAX DUE	AMOUNT OF TAX
<b>SECTION 900:</b>			<b>SECTION 904:</b>			
(1) Automobiles, trucks, wagons, etc.	3%	\$.....	(12) Litteria, etc.	10%	\$.....	Total tax..... \$.....
(2) Automobiles, motor cycles, etc.	5%	.....	(13) Hunting garments, etc.	10%	.....	Less overpayment for month of..... 192.....
(3) Tires, parts, etc.	5%	.....	(14) Yachts, motor boats, etc.	10%	.....	Total amount of tax due.....
(4) Cameras and lenses	10%	.....				Penalty 25%.....
(5) Photographic films and plates	5%	.....	(1) Carpets and rugs	5% of costs	(See par. 1 reverse side.)	Penalty 5%.....
(6) Candy	3%	.....	(2) Trunks	5% of costs	(See par. 2 reverse side.)	Interest.....
(7) Firearms, shells, etc.	10%	.....	(3) Valises, suit cases, etc.	5% of costs	(See par. 2 reverse side.)	Total amount due..... \$.....
(8) Hunting and sports knives	10%	.....	(4) Purse, pocketbooks, etc.	5% of costs	(See par. 2 reverse side.)	
(9) Dirk knives, daggers, etc.	10%	.....	(5) Portable lighting fixtures	5% of costs	(See par. 2 reverse side.)	
(10) Cigar holders, etc.	10%	.....	(6) Fans	5% of costs	(See par. 2 reverse side.)	
(11) Automatic sewing machines	5%	.....				
Automatic washing machines	10%	.....				

I swear (or affirm) that the foregoing is a true return of the amount of tax due in respect to the above-mentioned articles for the month of ..... 192, and that the amount deducted for overpayment is allowable by law. Sworn to and subscribed before me this ..... day of ..... 192

(Name) or (Witness) (See paragraph 4 on back) (Title) or (Witness)

Signed

(State whether individual owner of business, member of firm, or if owner of corporation or duly authorized manager or agent, give title.)

Return with remittance should be sent to the Collector of Internal Revenue for your district and not to the Commissioner of Internal Revenue at Washington, D. C. (See instructions, par. 4, on reverse of this form.) If you have nothing to report, make notation to that effect on this form and return to the Collector of Internal Revenue.

2-11535

DUPLICATE RETURN—This form must be returned to the Collector of Internal Revenue

[Obverse of Form 728.]

## EXCISE TAXES REGULATIONS.

## INSTRUCTIONS.

(For full instructions, see Regulations No. 47, Revised.)

1. **TAX.**—Section 900 of the Revenue Act of 1921 provides: "That from and after January 1, 1922, there shall be levied, assessed, collected, and paid upon the following articles sold or leased by the manufacturer, producer, or importer, a tax equivalent to the following percentages of the price for which so sold or leased:

	Rate.
"(1) Automobile trucks and automobile wagons (including tires, inner tubes, parts, and accessories therefor, sold on or in connection therewith or with the sale thereof).....	3 per cent.
"(2) Other automobiles and motor cycles (including tires, inner tubes, parts, and accessories therefor, sold on or in connection therewith or with the sale thereof), except tractors.....	5 per cent.
"(3) Tires, inner tubes, parts, or accessories for any of the articles enumerated in subdivision (1) or (2), sold to any person other than a manufacturer or producer of any of the articles enumerated in subdivision (1) or (2).....	5 per cent.
"(4) Cameras, weighing not more than 100 pounds, and lenses for such cameras.....	10 per cent.
"(5) Photographic films and plates (other than moving-picture films).....	5 per cent.
"(6) Candy.....	3 per cent.
"(7) Firearms, shells, and cartridges, except those sold for the use of the United States, any State, Territory, or possession of the United States, any political subdivision thereof, or the District of Columbia.....	10 per cent.
"(8) Hunting and bowie knives.....	10 per cent.
"(9) Dirk knives, daggers, sword canes, stilettos, and brass or metallic knuckles.....	100 per cent.
"(10) Cigar or cigarette holders and pipes composed wholly or in part of meerschaum or amber humidor, and smoking stands.....	10 per cent.
"(11) Automatic slot-device vending machines.....	5 per cent.
Automatic slot-device weighing machines.....	10 per cent.
(If the manufacturer, producer, or importer of any such machine operates it for profit, he shall pay a tax in respect to each such machine put into operation equivalent to 5 per centum of its fair market value in the case of a vending machine, and 10 per centum of its fair market value in the case of a weighing machine.)	
"(12) Livories and livery boots and hats.....	10 per cent.
"(13) Hunting and shooting garments and riding habits.....	10 per cent.
"(14) Yachts and motor boats not designed for trade, fishing, or national defense; and pleasure boats and pleasure canoes if sold for more than \$100.....	10 per cent."

2-11536

2. Section 904 of the Revenue Act of 1921 provides: "That from and after January 1, 1922, there shall be levied, assessed, collected, and paid, in lieu of the taxes imposed by section 904 of the Revenue Act of 1918, upon the following articles sold or leased by the manufacturer, producer, or importer, a tax equivalent to 5 per centum of so much of the price for which so sold or leased as is in excess of the price hereinafter specified as to each such article:

- "(1) Carpets and rugs, including fibre, on the amount in excess of \$4.50 per square yard in the case of carpets and \$6.00 per square yard in the case of rugs;
- "(2) Trunks, on the amount in excess of \$35 each;
- "(3) Valises, traveling bags, suit cases, hat boxes used by travelers, and fitted toilet cases, on the amount in excess of \$25 each;
- "(4) Purses, pocketbooks, shopping and hand bags, on the amount in excess of \$5 each;
- "(5) Portable lighting fixtures, including lamps of all kinds and lamp shades, on the amount in excess of \$10 each;
- "(6) Fans, on the amount in excess of \$1 each."

3. **COMPUTATION OF TAX.**—The tax under sections 900 and 904 is based on the sale price of the goods sold and should be computed on each transaction.

4. **RETURNS AND PAYMENT OF TAX.**—Return with remittance covering taxes due in any month must be in the hands of the Collector of Internal Revenue (or his authorized representative) of the district in which the principal office or place of business of the person making the return is located on or before the last day of the succeeding month. Returns must be signed and sworn to before an officer authorized to administer oaths, but if the tax is less than \$10 the return may be signed or acknowledged before two subscribing witnesses.

5. **CREDITS.**—In case of any overpayment of tax due to an error in calculation, credit may be taken therefor against taxes due upon any subsequent monthly return. Credit may also be taken as outlined in the regulations. A complete and detailed record of such overpayment must be kept by the person taking credit therefor. In case credit is taken on this return for an overpayment made on a previous return, full information must be attached showing the reasons therefor and designating the kind of tax, the month for which the previous return was filed, and the date of payment. In the case of illegal or erroneous payment, such as exports, nontaxable articles, etc., claim for refund on Form 46 must be filed.

6. **RECORDS.**—Every manufacturer, producer, or importer required to make returns must keep such records as will clearly show each taxable transaction, in order that returns may be easily verified by revenue officers.

7. **PENALTIES.**—Failure to file on time, 25 per cent of tax. Failure to pay on time, 5 per cent of tax and 1 per cent interest a month. Severe penalties for failure to file returns or for false or fraudulent returns.

2-11536

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UNITED STATES INTERNAL REVENUE  
Form 728—Revised Sept., 1922

## RECEIPT FOR PAYMENT OF MANUFACTURER'S EXCISE TAXES

Month of \_\_\_\_\_, 192

THIS RECEIPT NOT TO BE DETACHED BY TAXPAYER

NOT VALID UNLESS RECEIPTED BY CASHIER

TAXPAYER WILL ENTER AMOUNT PAID IN THE SPACE PROVIDED THEREFOR

NAME AND ADDRESS	DATE PAID	AMOUNT PAID
	(CASHIER'S STAMP)	

2-11536a

[Reverse of Form 728 and tax receipt form.]

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WAR TAX 908 SERVICE



## EXCISE TAXES REGULATIONS.

UNITED STATES INTERNAL REVENUE  
Form 728-A—Revised Sept., 1922MISCELLANEOUS EXCISE TAXES  
(Title IX, Sections 902 and 905, of the Revenue Act of 1921)

CHARACTER OF TAX.	RATE OF TAX.	AMOUNT OF TAX.
Section 902— Sculpture, paintings, statuary, art paraphernalia, bronzes	5%	
Section 905— Jewelry, real or imitation, precious and imitation stones, clocks, watches, etc.	5%	
I swear (or affirm) that the foregoing is a true return of the amount of tax due on each of the above-mentioned articles for the month of _____, 192____, and that the amount deducted for overpayment is		
Signed _____		
(State whether individual owner of business, member of firm, or if officer of corporation or duly authorized manager or agent, give title)		
Total tax collected _____		
Less overpayment for month of _____, 192____		
Total amount of tax due _____		
Penalty, 25% _____		
Penalty, 5% _____		
Interest _____		
Total amount due _____		
Sworn to and subscribed before me this _____ day of _____, 192____		
(Name) or (Witness) (See paragraph 3 on back) (Title) or (Witness)		

Return with remittance should be sent to the Collector of Internal Revenue for your district and not to the Commissioner of Internal Revenue at Washington, D. C. (See Instructions, par. 3, on reverse of this form.) If you have nothing to report, make notation to that effect on this form and return to the Collector of Internal Revenue.

ORIGINAL RETURN—This form must be returned to the Collector of Internal Revenue

8-11537

[Obverse of Form 728-A.]

## INSTRUCTIONS.

(For full instructions, see Regulations No. 45, Revised.)

1. **TAX.**—Section 902 of the Revenue Act of 1921 provides: "That there shall be levied, assessed, collected, and paid upon sculpture, paintings, statuary, art porcelains, and bronzes, sold by any person other than the artist, a tax equivalent to 5 per centum of the price for which so sold. This section shall not apply to the sale of any such article (1) to an educational institution or public art museum, or (2) by any dealer in such articles to another dealer in such articles for resale."

Section 905 of the Revenue Act of 1921 provides: "That on and after January 1, 1922, there shall be levied, assessed, collected, and paid (in lieu of the tax imposed by section 905 of the Revenue Act of 1918) upon all articles commonly or commercially known as jewelry, whether real or imitation; pearls, precious and semiprecious stones, and imitations thereof; articles made of, or ornamented, mounted or fitted with, precious metals or imitations thereof or ivory (not including surgical instruments, eyeglasses, and spectacles); watches; clocks; opera glasses; longuettes; marine glasses; field glasses; and binoculars; upon any of the above when sold by or for a dealer or his estate for consumption or use, a tax equivalent to 5 per centum of the price for which so sold."

2. **COMPUTATION OF TAX.**—Any person other than the artist who sells any of the articles enumerated in section 902 is required to make returns based on sales. Any dealer who sells any of the articles enumerated in section 905 is required to make returns based on sales.

3. **RETURNS AND PAYMENT OF TAX.**—Return with remittance covering taxes collected in any month must be in the hands of the Collector of Internal Revenue (or his authorized representative) of the district in which the principal office or place of business of the person making the return is located on or before the last day of the succeeding month. Returns must be signed and sworn to before an officer authorized to administer oaths, but if the tax is less than \$10 the return may be signed or acknowledged before two subscribing witnesses.

4. **CREDITS.**—In case of any overpayment of tax due to an error in calculation, credit may be taken therefor against taxes due upon any subsequent monthly return. Credit may also be taken as outlined in the regulations. A complete and detailed record of such overpayment must be kept by the person taking credit therefor. In case credit is taken on this return for an overpayment made on a previous return, full information must be attached showing the reasons therefor and designating the kind of tax, the month for which the previous return was filed and the date of payment.

5. **RECORDS.**—Every person required to make returns under sections 902 and 905 must keep such records as will clearly show each taxable transaction, in order that returns may be easily verified by revenue officers.

6. **PENALTIES.**—Failure to file on time, 25 per cent of tax. Failure to pay on time, 5 per cent of tax and 1 per cent interest a month. Severe penalties for failure to file returns or for false or fraudulent returns.

2-11537

8-11537

[Reverse of Form 728-A.]

UNITED STATES INTERNAL REVENUE  
Form 728-A—Revised Sept., 1922

## RECEIPT FOR PAYMENT OF MISCELLANEOUS EXCISE TAXES

Month of \_\_\_\_\_, 192\_\_\_\_

THIS RECEIPT NOT TO BE DETACHED BY TAXPAYER

NOT VALID UNLESS RECEIPTED BY CASHIER

TAXPAYER WILL ENTER AMOUNT PAID IN THE SPACE PROVIDED THEREFOR

NAME AND ADDRESS	DATE PAID	AMOUNT PAID
	(CASHIER'S STAMP)	

8-11537A

[Form 728-A tax receipt form.]

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WAR TAX 909 SERVICE

**EXCISE TAXES REGULATIONS.****REGULATIONS 47**

Relating to the

**EXCISE TAXES ON SALES BY THE MANUFACTURER**

Under

Sections 900 and 904 of Title IX of the Revenue Act of 1921.

[Promulgated January 6, 1922. Released for publication February 1, 1922.]  
(T. D. 3278)**CONTENTS.**

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WAR TAX 910 SERVICE



**EXCISE TAXES REGULATIONS.**

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**Imposition of tax.**

**4540 Art. 1. Effective date.**—The tax is imposed on all articles sold or  
**4500** leased by the manufacturer, producer, or importer on or after January  
**4521** 1, 1922, even though manufactured, produced, or imported before  
that date.

**4541 Art. 2. Use of terms.**—In these regulations, for convenience, unless  
obviously inapplicable, the term "manufacturer" is used to include  
also "producer" and "importer;" the term "sale" or "sold" to include "lease"  
of "leased;" the term "purchaser" to include "lessee," and the term "vendor"  
to include "lessor." The term "person" is used to include partnerships,  
corporations, and associations, as well as individuals.

**4542 Art. 3. Basis of tax.**—The tax is imposed on the sale by the manu-  
facturer and should be returned and paid by him whether the sales  
price is actually collected or not. It is measured by the price for which  
the article is sold by the manufacturer and not by the list price where that  
differs from the actual sales price. If the price of a taxable article is increased  
to cover the tax, and the article is sold at such price, including the tax, the  
tax is on such increased price.

**4543** The manufacturer may reimburse himself in the amount of the tax  
by agreement with the purchaser in the following manner: (a) By  
quoting the selling price and the tax in separate and exact amounts, and  
where invoices are rendered, by segregating these amounts on the invoices as  
outlined in examples (1) and (6) below; or (b) by stating to the purchaser  
in advance of the sale what portion of the quoted price represents the price  
charged for the article and what portion represents tax, and where invoices  
are rendered by invoicing in the manner outlined in examples (2) and (3).

**EXCISE TAXES REGULATIONS.**

below, in which cases the amount of the tax need not be included in the price of the article in computing the tax.

**4544** Where goods are ordered direct from the manufacturer with no agreement as to price, the tax is based on the amount billed or invoiced to the purchaser as the selling price. Mere statements or agreements that the quoted or contract price includes the tax do not operate to exclude any part thereof from tax, unless the price is billed in the manner outlined in example (1), (2), (3), or (6) below.

**4545** Where a lump sum is specified as the price of a taxable article or articles, and other articles not taxable and not a component part of the taxable articles are included in the price, the tax attaches to the entire amount unless the selling prices of the taxable and nontaxable articles are segregated. In such case the tax will be measured by the price specified as the selling price of the taxable article or articles (examples 4 and 5). The following examples illustrate the method by which the manufacturer may separate the tax from the selling price in invoicing goods to the purchaser.

**4546** Example (1). A, the manufacturer, quotes a selling price to B of \$1 and bills the goods to B as:

“Article No. 1, selling price, \$1; tax, \$0.05.”

**4547** Example (2). A, the manufacturer, quotes a selling price of \$1.05, stating that the price includes a tax of 5 cents, and bills the goods to B as: “Article No. 1, selling price \$1.05, 5 cents of the total represents tax.”

**4548** Example (3). A, the manufacturer, quotes a selling price of \$1.05, stating that 1-21 of the price represents tax, and bills the goods to B as: “Article No. 1, selling price \$1.05, 1-21 of the total represents tax.”

It should be noted that example (3) applies only to articles taxable under section 900, and not to articles taxable under section 904.

**4549** The tax in examples (1), (2), and (3) is computed upon \$1, the quoted and actual selling price.

**4550** Example (4). A, the manufacturer, quotes a cost price or contracts to sell goods at \$1.05, including tax, and bills the goods to B as:

“Article No. 1, selling price including tax \$1.05.”

The tax is computed upon \$1.05, the quoted and invoiced selling price.

**4551** Example (5). A manufacturer sells an automobile to B, including insurance, gas, and oil, and bills it as: “One car, \$2,150.”

The tax is based on the full amount of \$2,150.

**4552** Example (6). If in example (5) the invoice separates the charges into items as, “car \$2,000, gas and oil \$20, insurance \$30, tax \$100,” the tax is based on \$2,000, the selling price of the car as specified.

**4553** **Art. 4. Discounts and expenses.**—A discount for cash or discount made subsequently to the sale can not be deducted in computing the price for the purpose of the tax.

**4554** An adjustment in price, where articles are sold over a period of time, under an agreement for a quantity rebate, or an agreement for a rebate on goods remaining unsold in the hands of the dealer, and which were purchased by such dealer within a definitely specified period, in case of a decline in the market, is held not to be a discount made subsequently to the sale, and the tax, if originally computed on the gross price, may be adjusted in the return for the month in which the price is finally determined. If in such cases the tax assumed to be due on the original selling price has been billed to the dealer and by him to the purchaser as a separate item, and collected from the purchaser, the overcollection of tax arising from the as-



**EXCISE TAXES REGULATIONS.**

justment of the sale price under the contract between the manufacturer and the dealer must be refunded to the purchaser.

**4555** Commissions to agents and other expenses of sale are not deductible from the price.

**4556** Freight and delivery charges are taxable as part of the sales price when the price to the purchaser includes transportation and delivery charges paid by the manufacturer, or when the amount charged the purchaser, whether billed as a separate item or not, does not represent the actual transportation charges.

**4557** Freight and delivery charges are not part of the sales price when the goods are sold at the factory or f. o. b. cars at place of manufacture, when the transportation charges are paid by the purchaser as a specific item, or when the goods are sold delivered at a definite price less actual transportation charges to be paid by the purchaser. [This Article 4 was amended by T. D. 3307, March 20, 1922, but was subsequently restored to read as formerly and as here by T. D. 3358, June 22, 1922.]

**4558** **Art. 5. Exchanges.**—If articles sold are returned and the sale entirely rescinded, no tax is payable, and if paid it may be credited against the tax included in a subsequent monthly return. (See article 40.) If a part only of the articles sold at one time is returned, and credit or rebate allowed by the vendor therefor, the portion of the tax to be credited will be only the proportion of the total tax paid which the amount allowed as a credit or rebate bears to the total sales price of all the articles.

**4559** If an article is sold under a guaranty as to its quality or service and is thereafter returned and a rebate made pursuant to the guaranty, the manufacturer may claim as a credit against the tax included in a subsequent return such portion of the tax originally paid in respect of the article as is proportionate to the amount of the price refunded.

**4560** Where any article taxable under section 900 or 904 is returned to the manufacturer thereof for adjustment, replacement, or exchange, under a guaranty as to quality or service, and a new article given pursuant to a guaranty, free or at a reduced price, the tax shall be computed on the actual price, if any, to be paid to the manufacturer for the new article.

**4561** If an article is sold and thereafter, before use, exchanged for another article of a higher price, the purchaser paying the difference, the manufacturer should pay the tax on the second sale, but may take as a credit against such tax such part of the tax paid on the returned article, which the amount allowed as a credit for the return of such article on the second sale bears to the amount of the purchase price in the case of the first sale. The tax also attaches to the subsequent sale by the manufacturer of the article so returned.

**4562** **Art. 6. Credit for taxes already paid.**—A manufacturer may take as a credit against the tax imposed on him in respect to the sale of any article taxable under section 900 an amount equal to any tax imposed under section 900 which he has reimbursed to the manufacturer from whom he purchased any article forming a component part (whether or not changed in form by process of manufacture) of the article sold by him and in respect to which tax is paid by him, provided the tax was billed to him as a specific item and in the exact amount of the tax. Similarly, he may take credit against a tax imposed on an article under section 904, a tax under the same section.



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Credit is not allowed unless: (1) The article forms a component part of an article sold by such manufacturer and in respect to which a tax is payable by him; (2) such manufacturer has, in fact, reimbursed the manufacturer from whom purchased, who has himself, in fact, paid the tax upon which such credit is sought; (3) unless the taxpayer keeps such records and evidence as will clearly establish his right to the same.

**4563** The following records and evidence will be deemed sufficient to establish this right of exemption: (1) Any record or statement showing the exact amount of tax paid upon such article; (2) a certificate or statement of the following tenor: "The undersigned hereby certifies that the articles on which credit for tax is claimed were tax paid and that said articles were used by \_\_\_\_\_ in the further manufacture of other articles taxable under section 900 of the Revenue Act of 1921. (Signed)\_\_\_\_\_." In cases of doubt, in order to avoid penalty for default if the claim is not established, the tax should be paid in full and application made for refund.

**4564 Art. 7. Who is a manufacturer.**—A manufacturer is generally a person who (1) actually makes a taxable article, or (2) by changes in the form of an article produces a taxable article, or (3) by the combination of two or more articles produces a taxable article. Under certain circumstances, however, the person who actually makes, produces, or assembles the taxable article is not the manufacturer for the purpose of the tax. There may be several stages of manufacture and several manufacturers, each of whom must pay a tax. In such cases the tax attaches on successive sales, subject to the provisions as to credits (see art. 6.). The following examples are merely illustrative:

**4565** Example 1. "A," an automobile manufacturer, sells an automobile in a knockdown condition but complete as to all the component parts. "B," a dealer, assembles these component parts into a complete usable automobile, without further manufacture, and sells the automobile. "A" is the manufacturer.

**4566** Example 2. "A," an automobile body manufacturer, sells an automobile body in a knockdown condition but complete as to all its component parts, to "B," a dealer, who assembles these component parts into a complete usable automobile body, and installs it, or causes it to be installed on a chassis which he has purchased from a manufacturer who is a different person from the manufacturer of the body, and sells the completed automobile. "A" is the manufacturer of the automobile body, but may sell the same to "B" tax free under the certificate provided for in article 14. "B" is the manufacturer of the automobile and subject to tax on the selling price of the completed automobile, but may take credit for the amount of tax paid by the manufacturer of the chassis. (See arts. 3 and 6.)

**4567** Example 3. "A," a dealer or jobber, contracts with "B" for the manufacture of a taxable article, whereby "B" receives from "A" the cost of materials and labor plus a specified profit. "A" is the manufacturer.

**4568** Example 4. "A," a dealer or jobber, contracts with "B" for the manufacture of a taxable article, whereby "A" furnishes "B" all or a portion of the material to be used and pays "B" for the labor plus a specified profit. "A" is the manufacturer.

**4569** Example 5. "A," a dealer or jobber, owns a patent, trade-mark, formula, or recipe for a taxable article, and contracts with "B" for the manufacture thereof, the contract specifying that "B" can manufacture



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the article only for "A"; that "A" will take the entire output; and that it will be sold by "A" as the manufacturer, "B's" name not appearing on the article. "A" is the manufacturer.

**4570 Art. 8. Tax payable by the manufacturer.**—The tax is to be paid by the manufacturer on all sales made directly by him or through an agent.

**4571** If the manufacturer has a sales agent or sales agency to whom he only nominally sells an article, but retains an interest in the profits from the resale of the article, the taxable sale is that made by the sales agent or sales agency.

**4572** On articles manufactured for a jobber by a foreign manufacturer, the jobber must pay the tax as the importer.

**4573** A receiver or trustee in bankruptcy of a manufacturer conducting a business under court order is liable to the tax upon articles sold by him.

**4574** Where a manufacturer consigns articles to a dealer, retaining ownership in them until they are disposed of by the dealer, the manufacturer must pay the tax upon the basis of the manufacturer's selling price on all goods sold to the dealer, as shown by reports to be procured by him monthly from the dealer. Where the agent of a manufacturer makes a sale, it is to be treated as a sale by the manufacturer.

**4575** Where a so-called sales agent or distributor is a separate corporation and the sale to it is absolute and at prices and under terms and conditions such as ordinarily obtain between persons dealing at arm's length with no further payment or benefit accruing to the manufacturer upon resale or otherwise except the receipt of dividends on stock holdings, the taxable sale is that made by the manufacturer to such sales corporation even though all or substantially all of the stock of such sales corporation is held by or for the benefit of the manufacturer or the stockholders in the manufacturing corporation. Where, however, there are special arrangements between the manufacturer and the selling corporation such as special terms, prices, etc., the taxable sale is the sale by the selling corporation as the selling agent of the manufacturer. The same rule applies in the case of the selling corporation which owns substantially all the stock of a manufacturing corporation.

**4576 Art. 9. When tax attaches.**—The tax attaches when the title to an article passes from the manufacturer to the purchaser pursuant to a contract of sale.

**4577** When title passes is a question of fact dependent upon the intention of the parties as gathered from the contract of sale and the attendant circumstances.

**4578** Where goods are segregated from other goods owned by the vendor and it is the intention of both the vendor and the purchaser at the time the goods are so segregated that they shall then belong to the purchaser, the title will be presumed to pass at such time.

**4579** In the absence of an intention to the contrary the title is presumed to pass upon delivery of the article to the purchaser or to a carrier for the purchaser.

**4580** In the case of a conditional sale, where title is reserved in the vendor until payment of the purchase price in full, the tax attaches (a) upon such payment, or (b) when title passes if before completion of the payments, or (c) when, before completion of the payments, the dealer disposes of the

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sale by charging off by any method of accounting he may adopt the unpaid portion of the contract price, or (d) when the vendor discounts the notes of the purchaser for cash or otherwise, or (e) when the vendor transfers to another his title in the article sold.

**4581 Art. 10. Sales to the Government or a State.**—The tax applies to articles enumerated in sections 900 and 904, except those enumerated under subdivision 7, section 900 (see art. 20), when sold to the United States Government. The same is true of articles sold to a State or political subdivision thereof, even though they are to be paid for entirely out of public moneys and are to be used in the carrying on of governmental operation. Where the Government supplies a manufacturer with all materials and parts, except a small portion furnished by the manufacturer under a contract stipulating that the manufacturer shall be guaranteed a certain profit, no tax is payable. Articles manufactured for Government use in plants taken over and operated by the Government are not subject to tax. The rules applicable to the taxability of sales to the United States Government apply equally in the case of articles sold to foreign Governments. (See also art. 20.)

**Automobiles.**

**4582 Art. 11. Automobiles: Scope of tax.**—An automobile truck, automobile wagon, or other automobile is a self-propelling vehicle designed to transport along highways and roads persons or property or both.

**4583** Where the vehicle is capable of transporting both property and persons, the primary use for which it is designed will control as to whether it is taxable at 3 per cent under subdivision (1) as an automobile truck or automobile wagon, or at 5 per cent under subdivision (2) as an "other automobile."

**4584** The act specifically exempts tractors. A tractor is a machine operated and controlled by its own motive power, and designed to draw or pull, as distinguished from carry, a load. So-called tractors or "semitractors," which carry a portion of the load, are taxable as automobile trucks or automobile wagons.

**4585** Trailers are not taxable. A trailer is a vehicle not operated or controlled by its own motive power, but which is pulled or drawn behind another vehicle containing the motive power. So-called trailers or "semitrailer" so designed that a portion of the load or the weight thereof is carried or borne by the tractor or "semitractor" are taxable as "parts" of automobile trucks or automobile wagons.

**4586** A usable substantially completed automobile or automobile truck produced by assembling new parts of trucks or cars is subject to tax, but a rebuilt car is not subject to tax as such, although the new parts thereof are subject to tax when sold by the manufacturer. (See Arts. 12 and 13 for examples of articles taxable and not taxable, and Art. 15 for the classification of chassis.)

**4587 Art. 12. Automobile trucks and automobile wagons.**—The tax is 3 per cent of the price for which automobile trucks and automobile wagons are sold by the manufacturer. It applies to automobile trucks and automobile wagons primarily designed or adapted for the transportation of property along highways and roads, although persons may incidentally



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be transported at the same time, as outlined in article 11, and to automobile truck and automobile wagon chassis as defined in article 15.

**4588** For example, fire apparatus, including fire engines, hose carts, hook and ladder trucks, water-tower trucks, etc., tank trucks for carrying oil, gasoline, water, etc., moving and furniture vans, and drays, delivery wagons, etc., are all taxable as automobile trucks and wagons. Automobile hearses are taxable as automobile trucks or automobile wagons.

**4589** An automobile truck or automobile wagon formed by joining together a so-called tractor or "semitractor" which carries or bears a portion of the load, and a so-called trailer or "semitrailer" is taxable as whole as an automobile truck or an automobile wagon.

**4590** When sold separately the so-called tractor or "semitractor" is taxable as an automobile truck or automobile wagon, and the so-called trailer or "semitrailer" as a "part" of an automobile truck or automobile wagon.

**4591** Motor-driven machines for pulling or drawing vehicles around factories and railway stations, small trucks for handling baggage and trunks at railway stations and for transporting materials, articles, or goods around and adapted for restricted use in factory yards or elsewhere as distinguished from use on highways and roads, are not subject to tax.

**4592** Self-propelling motor-driven machines, such as concrete mixers, stone crushers, excavating shovels, ditch diggers, etc., and machines which perform a mechanical function as they move along highways and roads, such as road graders, road scrapers, street sweepers, road sprinklers and oilers, are not taxable. Where, however, the mechanical part of a machine, as the mixing machine of a concrete mixer, the blades of a road scraper, the tank of a street sprinkler, or the boiler of a road oiler, is superimposed or mounted on a truck chassis, the chassis is taxable at 3 per cent when sold by the manufacturer.

**4593** Motor-propelled wheel or rolling chairs, motor-driven machine-gun and artillery carriages of the tractor type, motor-driven railroad cars and vehicles designed and adapted solely for use on rails or tracks, and not capable of use on highways and roads, are not taxable.

**4594** Any tires, inner tubes, parts, or accessories for automobile trucks and automobile wagons sold on or in connection therewith or with the sale thereof are taxable at 3 per cent as part of the selling price of the automobile truck or automobile wagon. This applies only to such tires, inner tubes, parts, or accessories as are not in excess of the quantities usually sold in the ordinary course of trade to a single customer at the time and in connection with the sale of an automobile truck or an automobile wagon. Any quantity of tires, inner tubes, parts, or accessories in excess of this amount is taxable under subdivision (3) at 5 per cent of the selling price thereof.

**4595** **Art. 13. Other automobiles and motor cycles.**—The tax is 5 per cent of the price for which such articles are sold by the manufacturer. It applies to automobiles primarily designed for carrying persons, although property may incidentally be transported at the same time, as outlined in Article 11, and to other automobile chassis as defined in Article 15.

**4596** It also applies to all motor cycles sold separately and to motor cycles sold with side cars attached.

**4597** Automobiles that are designed and primarily adapted for the transportation of persons as distinguished from property are taxable as "other automobiles." For example, ordinary passenger or pleasure cars, taxicabs,

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automobile busses, sight-seeing cars, hotel busses, omnibusses, police patrols, ambulances, cars used by fire department chiefs and marshals, mourners' coaches with accommodations for persons other than that afforded by the seat occupied in whole or in part by the driver, etc.

**4598** Where an automobile chassis of such construction that it is ordinarily used as an automobile truck or an automobile wagon is fitted with a body designed for the carriage of persons, the completed whole is taxable at 5 per cent as an "other automobile."

**4599** A side car sold separately from a motor cycle is taxable as a "part" under subdivision (3).

**4600** Tires, inner tubes, parts and accessories for other automobiles and motor cycles sold on or in connection therewith or with the sale thereof or separately are taxable at 5 per cent.

## Automobile Parts and Accessories.

**4601** Art. 14. Tires, inner tubes, parts, and accessories sold to manufacturers.—The words "tires, inner tubes, parts, or accessories" shall be understood to embrace only such tires, inner tubes, parts, or accessories as have reached such a stage of manufacture that they constitute articles commonly or commercially known as "tires, inner tubes, parts, or accessories," and shall not be understood to embrace raw materials used in the manufacture of such articles.

**4602** Unvulcanized sheet rubber, liquid rubber vulcanizing cement, and friction fabrics are considered raw materials, and are exempt from tax.

**4603** Any article which has reached a state of manufacture wherein it is in itself a component part or accessory, and is of such a nature that it may be used or attached by an ordinary repair man or individual user as distinguished from a manufacturer or producer, is subject to tax as a "part or accessory."

**4604** Subdivision (3) exempts from tax sales of tires, inner tubes, parts, or accessories to a manufacturer or producer of automobile trucks, automobile wagons, other automobiles, motor cycles, tires, inner tubes, parts, or accessories.

**4605** In order to come within the exemption of the statute, the sale must be made by a manufacturer and such manufacturer must, at the time the goods are shipped or sold (whichever is prior), have in his possession an order or contract of sale, with certificate of the purchaser printed thereon or in writing, permanently attached thereto, to the effect that the purchaser is a manufacturer of automobile trucks, automobile wagons, other automobiles, motor cycles, tires, inner tubes, parts, or accessories; that he is purchasing the articles in question as such manufacturer for resale in some form or manner, or for free replacement under contract or guaranty; and that he will account to the internal-revenue collector and pay the tax on the sale of such articles, unless such sales by him are exempted as provided in article 16 on account of being purchased for other uses or are made to another manufacturer of automobile trucks, automobile wagons, other automobiles, motor cycles, tires, inner tubes, parts, or accessories for resale by him in some form or manner or for free replacement, in which case he will require the same form of certificate from such manufacturer; that when such tires, inner tubes, parts, or accessories are sold other than on or in connection with the sale of new automobile trucks, wagons, automobiles, or motor cycles he will pay the tax on such sales (unless exempted in accordance with the regulations); that when



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such articles are sold on or in connection with the sale of such new vehicles he will pay the tax on the selling price of such vehicles, including such articles.

**4606** Manufacturers furnishing such certificate will be deemed manufacturers within the meaning of the law and subject to the tax imposed on sales of such articles by manufacturers, unless the sales are made to another manufacturer or producer of automobile trucks, automobile wagons, other automobiles, motor cycles, tires, inner tubes, parts, or accessories for resale by him in some form or manner or for free replacement under a contract or guaranty, who furnishes a certificate so stating.

**4607** Jobbers or dealers, who are not manufacturers, and users who are not manufacturing for resale, are not entitled to purchase tax free under certificate.

**4608** Following is a form of the certificate or statement which will be accepted and in substance must be strictly adhered to:

The undersigned hereby certifies that he is a manufacturer or producer of automobile trucks, automobile wagons, other automobiles, motor cycles, tires, inner tubes, parts, or accessories, and that the tires, inner tubes, parts, or accessories purchased hereunder are purchased by him as such a manufacturer or producer for resale in some form or manner or for free replacement under contract or guaranty and agrees if any of the tires, inner tubes, parts, or accessories are sold by him exempt from tax to another manufacturer or producer of automobile trucks, automobile wagons, other automobiles, motor cycles, tires, inner tubes, parts, or accessories for like purposes he will require a similar certificate from such manufacturer or producer. The undersigned further agrees that in respect to all tires, inner tubes, parts, or accessories sold by him, unless such sale is made to such a manufacturer or producer, he will pay the tax on such sale direct to the internal-revenue collector, including it in his tax return covering the month in which such sale is made; said tax to be paid on the basis of the taxpayer's selling price of such articles when sold other than on or in connection with the sale of new automobile trucks, automobile wagons, other automobiles, motor cycles, tires, inner tubes, parts, or accessories, and on the selling price of such vehicles or articles when the same includes such articles.

**4609** If it is impracticable to furnish a certificate for each order, a certificate covering all orders between given dates (such period not to exceed a month) will be accepted. If in any case such an order and certificate can not be produced on demand of any authorized agent of the department, the tax in respect to the sale will be considered in default.

**4610** Where the form of certificate outlined in this article is used it must be in the exact form specified, except that when such form is used to cover orders for a period of one month the language may be altered to indicate that fact.

**4611** **Art. 15. Definition of parts.**—A "part" for an automobile truck, automobile wagon, other automobile, or motor cycle is any article designed or manufactured for the special purpose of being used as or to replace a component part of any such vehicle and which by reason of some peculiar characteristic is not such a commercial commodity as would ordinarily be sold for general use and which is primarily adapted only for use as a component part of such vehicle.

**4612** The term includes bodies, wheels, engines, springs, axles, radiators, etc. When sold separately a side car and a so-called trailer or "semi-trailer" so designed that a portion of the load or the weight thereof is carried or borne by the tractor or "semitractor" are taxable as "parts."

**4613** Mere stock or commercial commodities, such as bolts, nuts, washers, screws, etc., though used as components for such vehicles, are not "parts" within the meaning of subdivision (3). Articles, however, which

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ordinarily would be classed as commercial commodities become parts when, because of their design or construction, they are primarily adapted for use as component parts of such vehicles.

**4614** Component parts of articles taxable under this definition are taxable when sold separately if they have reached such stage of manufacture that they are primarily adapted for use as a component part. Blow-out shoes are subject to tax as "parts" regardless of the fact that they may be made from old casings.

**4615** A chassis provided with a "superstructure" of such design that it is without substantial additions adaptable for hauling heavy loads is an "automobile truck" or "automobile wagon" and taxable at the rate of 3 per cent when sold by the manufacturer thereof. The term "superstructure" means any chassis frame of steel or wood or other material which is adaptable by the addition of a few bolsters or planks for carrying a heavy load. A chassis not so equipped is an "other automobile" or a "part" taxable at the rate of 5 per cent when sold by the manufacturer thereof unless (1) the manufacturer has actual knowledge from the construction of the chassis which he sells that it is to be used as an automobile truck or automobile wagon or has in his possession at the time the chassis is shipped or sold (whichever is prior) an order or contract of sale with a certificate of the purchaser printed thereon or in writing permanently attached thereto, showing that the chassis specified in the order is to be so used, in which case the chassis will be taxable at the rate of 3 per cent when sold by the manufacturer thereof; or (2) unless the manufacturer has in his possession at the time the chassis is shipped or sold (whichever is prior) an order or contract of sale with certificate of the purchaser printed thereon or in writing permanently attached thereto, showing that the chassis specified in the order is to be used by him in the further manufacture and sale of an automobile truck, automobile wagon, or other automobile, in which case the chassis may be sold as a "part" free from tax if the purchaser furnishes the certificate provided for in article 14, for purchasing parts tax free. In the case of a chassis which is taxable as an automobile truck or automobile wagon at the rate of 3 per cent, the manufacturer of the chassis must return the tax to the Government in all instances.

**4616** It should be noted that a chassis which is essentially an automobile truck or automobile wagon chassis can not be sold tax free under the certificate provided for in article 14. The exemption from tax in the sale of a chassis can be taken advantage of only in the sale of a chassis that is essentially a passenger car chassis (as distinguished from an automobile truck or automobile wagon chassis), and which is to be used by the purchaser in the further manufacture and sale of an automobile truck, automobile wagon, or other automobile.

**4617** In case the purchaser of a tax-paid chassis further completes the chassis by the addition of a body and sells the completed automobile truck, automobile wagon, or other automobile, the tax must be paid by him on his selling price of the complete automobile truck, automobile wagon, or other automobile less any tax previously paid by the manufacturer of the chassis from whom he purchased it. (See Arts. 3 and 6.)

**4618** A manufacturer who purchases from the manufacturer thereof tires, inner tubes, parts, or accessories for use in further manufacturing an automobile truck, automobile wagon, other automobile or motor cycle, may purchase them tax exempt by furnishing the certificate provided for in article 14.



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**4619** In all cases where a subsequent manufacturer does not furnish the certificate provided for in article 14, and the original manufacturer pays the tax thereon, if the subsequent manufacturer uses such tires, inner tubes, parts, or accessories in the manufacture and sale of an automobile truck, automobile wagon, other automobile, motorcycle, tire, inner tube, part, or accessory, he may take credit for such tax paid by the original manufacturer, in the same manner as is provided in the case of a chassis.

**4620** If a person manufactures for sale separately parts or accessories and is also engaged in the business of repairing and rebuilding automobile trucks, automobile wagons, other automobiles, or motor cycles, such parts or accessories used for repair or rebuilding purposes are subject to taxation upon the amount charged for the entire job, unless the amount charged for the parts so used is billed separately, in which case the tax will attach to the sale price of the parts only.

**4621** A concern which does not manufacture for sale separately any part or accessory, but is engaged in doing strictly a repair business, and makes only occasionally a part which may be needed for an immediate repair job performed by it, is not considered a manufacturer and is not required to pay any tax in respect to parts so manufactured and used.

**4622** A person, partnership, or corporation engaged in the business of building over automobile tops or bodies for installation on new or old chassis is not considered to be doing strictly a repair business, even though all such tops or bodies are manufactured as needed for an immediate job, but is held to be a manufacturer of automobile "parts or accessories" and subject to a tax as such.

**4623** **Art. 16. Definition of accessories.**—An "accessory" for an automobile truck, automobile wagon, other automobile, or motor cycle is any article designed to be attached to or used in connection with such vehicle to add to its utility or ornamentation and which is primarily adapted for use in connection with such vehicle, whether or not essential to its operation.

**4624** The term "accessories" includes, for example, automobile tops, back and side curtains, horns, speedometers, self-starters, spot lights, shock absorbers, tire pumps, and pressure gauges. (This paragraph is as amended by T. D. 3415, Dec. 2, 1922.)

**4625** Articles which have a general commercial use and which are not especially designed and peculiarly adapted for use in connection with automobile trucks, automobile wagons, other automobiles, or motor cycles are not subject to tax as "parts" or "accessories." Thus a wrench or other tool of a kind ordinarily sold in hardware stores for general purposes is not subject to tax when sold separately, but if incorporated in an automobile tool kit, designed, intended, advertised, or held out for use on an automobile as distinguished from garage or shop equipment, is taxable as part of the completed kit.

**4626** A wrench or other tool of special design or construction primarily adapted for use in connection with automobiles is taxable.

**4627** If any doubt exists as to the special adaptability of any article, the fact of its sale by the manufacturer to be used with an automobile, or to an automobile accessories dealer, would determine its taxability.

**4628** Robes, goggles, and lunch kits are not subject to tax. Asbestos brake-band linings, generator tubing, and radiator hose are not subject to tax unless sold in prepared sizes, lengths, shapes, or with such fittings as make them adapted for use only on or in connection with automobiles.

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**4629** Parts or accessories for automobile trucks, automobile wagons, other automobiles, or motorcycles primarily adapted for use on or in connection therewith when sold for any other purpose are not taxable provided the purchaser files with his order a statement that such parts or accessories are to be used on or in connection with another article of commerce not enumerated or included in subdivisions (1), (2), or (3) of section 900. For example, a self-starter primarily adapted for use on an automobile if sold to a manufacturer of motor boats, such manufacturer stating in his order that it is to be used in the manufacture of a motor boat and not upon an automobile, is not taxable.

## Cameras

**4630 Art. 17. Cameras and lenses.**—The tax is 10 per cent of the price for which cameras weighing not more than 100 pounds, and lenses for such cameras, are sold by the manufacturer. Stands and tripods are not to be weighed in computing the weight of the camera. Process and motion-picture cameras are subject to the tax. Toy cameras are taxable if capable of taking a picture. Parts of cameras other than lenses are not taxable, unless sold in combination with a camera.

## Films

**4631 Art. 18. Photographic films and plates.**—The tax is 5 per cent of the manufacturer's selling price of photographic films and plates, other than moving-picture films. X-ray plates are taxable as photographic plates. Motion-picture film cut up and placed in packets inclosed in a patented wrapper and known as dental films are taxable under this section. Unsensitized squeegee, and ferrotype plates are not taxable.

## Candy

**4632 Art. 19. Candy.**—Candy within the meaning of this subdivision—  
**4506** (a) Includes chocolate creams, bonbons, gumdrops, jelly drops, jelly beans, imperials, caramels, stick candy, lozenges, taffies, candy kisses, wafers, fudges, or Italian creams, nougats, peanut brittle, sugared almonds, chocolate-covered fruits and nuts, glaze or candied fruits and nuts not specified in paragraph (b) of this subdivision; pop corn and other cereals or cereal products not specified in paragraph (b) of this subdivision, mixed with or covered with molasses, sugar, or other sweetening agent; hard candies, plain and chocolate-covered marshmallows; candy cough drops sold in bulk and without remedial claims; sweetened licorice; sweet chocolate and sweet-milk chocolate, whether plain or mixed with fruit or nuts, not specified in paragraph (b) of this subdivision; maple sugar mixed with fruit, nuts, etc., not specified in paragraph (b) of this subdivision; and all similar articles however designated; but

**4633** (b) Does not include cereal breakfast foods, cake and pastries, bitter chocolate which needs the addition of sugar before it becomes pleasing to the taste, powdered chocolate, maple sugar or sirup not mixed with nuts, etc., marshmallow paste, glaze or candied fruit peel and citron, or sweet chocolate, glaze or candied fruits and nuts sold by the manufacturer under circumstances where it is obvious from the condition of the product, method of packing, or from other facts in connection with the sale, that it will not be consumed in the form in which it is then sold.



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**4634** Where a manufacturer sells candy which is packed or put up for sale in a fancy or plain box or container the tax is computed upon the selling price of the candy and container, whether the container is billed separately or not. However, where candy is purchased and the purchaser selects a fancy box or container in which the candy is placed the tax attaches to the selling price of the candy and not to the cost of the box. In such cases, if the sale is billed, the container and candy must be billed as separate items. [Sweet chocolate manufactured and sold for consumption in the form sold, and not for cooking or domestic purposes, is within the meaning of the word "candy."—*Malley vs. Walter Baker & Co.* (281 Fed. 41.—1922 War Tax Service, p. 946.—T. D. 3344.)]

## Firearms

**4635** **Art. 20. Firearms, shells, and cartridges.**—A firearm is any weapon from which shot is discharged by an explosive. For the purpose of the act, firearms include only portable firearms, as pistols, revolvers, rifles, carbines, machine guns, shotguns, and fowling pieces. Shells and cartridges include projectiles for all such portable arms when in such completed state that they may be discharged from firearms without further manufacture.

## Knives

**4636** **Art. 21. Hunting knives, dirk knives, daggers, etc.**—A hunting or bowie knife is a knife with a blade over 3 inches in length, having a sharp point and one cutting edge, especially adapted for sticking, skinning, and cutting game. The knife may be of a rigid type, carried in a sheath, or it may be of a clasp type, containing devices other than the blades. Hunting and bowie knives are subject to a tax of 10 per cent of the manufacturer's selling price, whereas the weapons described in (9) are subject to a tax of 100 per cent upon the price for which sold by the manufacturers.

## Smokers' Articles

**4637** **Art. 22. Cigar and cigarette holders, pipes, humidors, and smoking stands.**—For the purpose of the tax a humidor is either (1) a device for maintaining moist atmosphere in any receptacle used for holding tobacco products, or (2) a portable receptacle used for holding tobacco products and fitted with a device for maintaining moist atmosphere therein. A smoking stand is (1) a tobacco ash tray having a pedestal and base, or (2) a stand supporting two or more ash trays in an upright position from a common base and designed to be placed on a table, desk, floor, or other surface. Cigar and cigarette holders and pipes, made wholly or in part of briar or other material, as distinguished from meerschaum, and fitted with a mouthpiece of amber, are taxable under section 900, even though ornamented, mounted, or fitted with precious metals or imitations thereof, or ivory. Cigar and cigarette holders and pipes with no meerschaum or amber in their composition are not taxable under section 900, but if ornamented, mounted, or fitted with precious metals or imitations thereof, or ivory, are taxable under section 905. (See Regulations 48) [page 934].

## Slot Machines

**4638** **Art. 23. Automatic slot-device machine.**—A machine used for both vending and weighing is taxable as a weighing machine. For the purpose of the tax fair market value is deemed to be the average

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wholesale price at which like machines have been sold by the manufacturer at wholesale during the month next preceding the month in which such machine is put into operation. In case there has been no prior sale of such machines, fair market value is deemed to be the average wholesale price for which similar machines are sold at the time the taxable machine is put into operation. Automatic machines operated by a hand lever released by dropping a coin are taxable as automatic machines.

**Liveries**

**4639 Art. 24. Liveries and livery boots and hats.**—For the purpose of the  
4512 tax the enumerated articles include the liveries and uniforms, hats, and caps, of personal or domestic servants as maids, nurses and like help, or doormen, footmen, pages, bell boys, ushers and similar employees of clubs, hotels, theaters, cafes, stores, bakeries, safe-deposit companies, newspapers and similar places; but uniforms otherwise taxed, and the uniforms of employees of public-service corporations, such as railroads, telegraph, and telephone companies, are not taxable. Uniforms manufactured for any of the personal or domestic servants mentioned in this article are defined to be such uniforms as are of a description, character, or design prescribed by the person in whose service they are worn as an evidence of such service and possess some distinctive characteristic to distinguish them from ordinary dress. A chauffeur's uniform is not taxable as a livery unless it has some distinctive characteristic to distinguish it from civil dress.

The following uniforms are not taxable under this section: Uniforms of members of an orchestra (not employed by a hotel or similar place); private watchmen; court attendants; letter carriers; elevator conductors and operators, or other similar employees of a public building; police reserves; Indians in the United States Indian Service; hospital attendants (private and public hospitals); Army and Navy officers and students at military schools; bands and musical organizations (when sold to the organization or to an individual member); actors or participants in any theatrical production; attendants of public zoological parks, museums of art and natural history; officers of steamship companies; chauffeurs of taxicab companies, if such taxicab companies are adjuncts of public service corporations; fraternal organizations, G. A. R., Spanish War Veterans, and the American Legion; overalls.

**Hunting Garments**

**4640 Art. 25. Hunting and shooting garments and riding habits.**—Hunting  
4513 and shooting garments and riding habits are deemed to include clothing primarily adapted for use in hunting, shooting, and riding, and commonly so used, such as hunting coats, sleeveless and other; duck shooters' jackets and coats; shooting caps and hats; shell belts; ladies' divided skirts and shell skirts; ladies' riding coats, men's riding breeches and coats, riding hats and caps.

Leather puttees and canvas or other leggings are not taxable as hunting or shooting garments or riding habits.

**Pleasure Boats**

**4641 Art. 26. Yachts and motor boats.**—Yachts and motor boats include  
4514 vessels driven by steam, sail, or motor and not designed for trade, fishing, or national defense. Vessels adapted to the public transport.

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tation of persons or property, or both, or for the carrying on of a commercial enterprise, are designed for trade. Thus, excursion steamers, freighters, pilot boats, lighters, and the like are designed for trade. To be classed as designed for fishing a vessel must be adapted to commercial fishing carried on as a means of livelihood. Vessels built according to plans and specifications previously approved by the Navy Department are held to be designed for national defense and are not taxable. The sale of vessels constructed according to a design adapted to racing, to the personal comfort or convenience of the owner, or to official use other than in national defense, is taxable as the sale of a yacht or motor boat not designed for trade, fishing, or national defense.

**4642** Pleasure boats include small open boats driven by oars, paddles, or sails, not capable of long trips, when adapted for pleasure or recreation of the owner or lessee. The sale thereof is taxable if the selling price is greater than \$100.

### Manufacturer also Retailer

**4643** **Art. 27. Manufacturer also retailer.**—It should be noted that the provisions of this subdivision apply only to articles taxable under section 900.

**4644** By "customarily sells" is meant a bona fide practice of selling the same article at both wholesale and retail, in substantial quantities, and not mere occasional sales at wholesale, with the bulk of the business done at retail. Only a manufacturer who does a legitimate wholesale and retail business and holds himself out as a wholesaler as well as a retailer with respect to the goods sold will be entitled to compute the tax upon goods sold at retail on the price for which like articles are sold by him at wholesale.

**4645** It should be noted that the provision of the law is that the tax in respect to retail sales shall be computed "on the price for which like articles are sold" at wholesale. To take advantage of this provision, therefore, it is necessary that a manufacturer shall have sold identical articles both at wholesale and at retail, in order to arrive at a basis for computing the tax.

**4646** In arriving at the basis of tax on retail sales, if a manufacturer has but one regular wholesale selling price or rate of discount from list, the basis of tax on all sales, whether wholesale or retail, is the same—that is, his regular wholesale selling price.

**4647** If a manufacturer sells regularly at wholesale at two or more rates of discount, it will be necessary for him to arrive at his *average* wholesale selling price to determine the basis of tax on retail sales; and this must be done by dividing the sum of the actual wholesale selling prices of the article in question by the total number of such articles so sold, and not by the process of "averaging discounts."

**4648** Except as provided herein, the basis of tax on retail sales for any given calendar month shall be the manufacturer's actual average wholesale selling price for the same month. But if the manufacturer desires to pass the tax on as such and to bill his customer a definite amount as tax previous to the determination of his actual average wholesale selling price for that month, he may base the tax on his average wholesale selling price for the second calendar month preceding that in which such retail sale is made, provided no change has been made in the meantime in his retail list price; if his retail list price has been changed, the average wholesale price determined as aforesaid must be adjusted accordingly, so that the amount upon

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which the tax is based will bear the same proportion to the retail list price then in force as the average wholesale price for the second preceding month bears to the retail list price then in force.

**4649** For example, the tax on retail sales made in June may be based on the manufacturer's average wholesale selling price for the same article during the month of April, provided he has made no change in his retail list price of the article. If in April his retail list was \$15 and his average wholesale price was \$10, and in June his retail list price had been increased 20 per centum, to \$18, the average wholesale price or basis of tax would be likewise increased 20 per centum, to \$12.

**4650** For the purpose of the tax, a wholesale sale is held to be a sale to a vendor for resale, or a sale to a consumer or user in wholesale quantity as distinguished from a sale to a consumer or user at a wholesale price. All sales at wholesale are subject to tax on the basis of the actual selling price of each article sold. (See Art. 3.)

### Repeal of Former Taxes

**4651** **Art. 28. Repeal of former taxes.**—The present taxes, under section 4516 900 of the 1921 Act, supersede the excise taxes imposed by section 900 of the Revenue Act of 1918 upon the sale of automobiles, musical instruments, sporting goods, chewing gum, cameras, toilet soaps, and similar articles. The Revenue Act of 1918 remains in force for the assessment and collection of all taxes which have accrued thereunder, and for the imposition and collection of all penalties or forfeitures which have accrued and may accrue, in relation to any such taxes. In the case of any tax imposed by section 900 of the Revenue Act of 1918, if there is a tax imposed by the present statute in lieu thereof, the provision imposing such tax remains in force until the corresponding tax under the present statute takes effect. See section 1400 of the statute [§8076].

### Colorable Sales

**4652** **Art. 29. Colorable sales.**—If a manufacturer, through the device of 4517 a selling branch or in any other manner, contrives to sell under the market price, with the result of benefiting his business or with the intent to cause such benefit, the tax shall be based on the fair market value of the articles and not on their nominal selling price, such fair market value to be determined by the Commissioner in each instance. (See Art. 8.)

**4653** If a manufacturer sells a taxable article to a subsidiary corporation at less than the fair market value thereof, the tax shall be based on the selling price of the subsidiary corporation.

### Carpets and Rugs

**4654** **Art. 30.**—For the purpose of the tax, carpets and rugs shall include 4522 all merchandise commonly or commercially known as carpets, rugs, or matting, either woven or felted, and whether used as floor coverings or otherwise, or mats when used as floor covering.

**4655** A rug shall be held to be distinguishable from carpet when manufactured as one piece or made by the manufacturer from breadths which are united so as to form one piece, of a distinctive manufacture, size, shape, and design, figured or plain. Carpet, when sold by the yard and sewed together so as to produce a certain size or design desired by the purchaser, shall not be deemed to be a rug within the meaning of the act.



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**4656** The unit of measurement is the square yard. Therefore, the size of a rug or the quantity of carpet shall be so calculated as to be capable of applying the tax thereto at so much per square yard. All lineal yardage, whether the strips be wider or narrower than 36 inches, must be converted into square measure. For example, a lineal yard of carpet of the ordinary width of 27 inches contains but three-quarters of a square yard. If such carpet is sold for more than \$3.37½ per lineal yard, it is taxable, because \$3.37½ per lineal yard is equivalent to \$4.50 per square yard. Fringe will not be considered in computing the yardage.

**4657** If carpet is sold at a specified price per yard and such price includes sewing, sizing, or laying, the tax shall attach to the combined price in excess of \$4.50 per square yard, unless the sewing, sizing, or laying is billed separately, in which case the tax attaches only to the price of the carpet in excess of \$4.50 per square yard.

**Trunks**

**4658** Art. 31. For the purpose of the tax the term "trunks" shall be held to include all receptacles which are commonly or commercially designated as trunks, designed to be used wherein to convey the effects of a traveler. It shall not, however, be held to include articles such as hampers, packing boxes or cases, nor chests designed to be used wherein to convey tools, medicine, or silver.

**Valises, Bags, Etc.**

**4659** Art. 32. For the purposes of the tax valises, traveling bags, and suit cases shall include all receptacles which are commonly or commercially designated as such or designed to be used wherein to carry in the hand the effects of a traveler. Hat boxes shall include any receptacle designed to be used wherein to convey hats in traveling. Fitted toilet cases shall not be limited in meaning to those designed and used for traveling purposes, but shall include all receptacles of any form whatsoever (other than purses, pocketbooks, shopping and hand bags, as defined in Art. 33) designed and fitted to contain toilet articles.

**Purses, Pocketbooks, Etc.**

**4660** Art. 33. For the purpose of the tax purses shall be deemed to include all receptacles used for carrying money on or about the person. The term "pocketbook" is broader in meaning than "purse," and includes any receptacle other than a purse for carrying money, papers, cards, memoranda, etc., in the pocket or on or about the person. The term "shopping and hand bags" shall include all bags, whether or not fitted with toilet articles, designed to be carried in the hand or on the arm for the purpose of conveying commodities or personal effects; but it shall not include articles such as valises, traveling bags, suit cases, and fitted toilet cases mentioned in article 32. The fact that a purse, pocketbook, hand or shopping bag is fitted with or for toilet articles does not take it from this subdivision nor make it taxable under the provisions of article 32.

**Portable Lighting Fixtures**

**4661** Art. 34. For the purpose of the tax, portable lighting figures and portable lamps shall be deemed to include all lighting devices adapted for interior illumination and not designed to be affixed permanently

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in one location, and all articles commonly or commercially known as such, irrespective of the principle of illumination used. A portable lamp and shade, even though sold at the same time, shall not be regarded as a single item, but as separate items, and in computing the tax the manufacturer shall be entitled to a separate \$10 deduction as to each item. For example, if the selling price of a lamp is \$50 and a shade \$30, even though the two articles are sold to one purchaser, the tax on the sale of the lamp will be \$2.00 and on the sale of the shade \$1.00.

**Fans**

**4662 Art. 35.** For the purpose of the tax, fans shall be deemed to include  
 4527 those articles commonly or commercially known by this name, designed to produce movements of the air by waving in the hand.

**Return and Payment of Tax**

**4663 Art. 36. Return and payment of tax.**—Each manufacturer of any of  
 4519 the articles hereinabove enumerated must make monthly returns under oath in duplicate on Form 728 (revised) [page 907], and pay the taxes imposed on such articles to the collector of internal revenue for the district in which his principal place of business is located.

**4664** Any return may, if the amount of the tax covered thereby is not in excess of \$10, be signed or acknowledged before two witnesses instead of under oath. Instructions for preparing will be found on the back of the form.

**4665** The returns must be rendered and the tax paid in time to be in the office of the collector or zone deputy on or before the last day of each month, covering all the transactions of the preceding month, the first return to cover all transactions after January 1, 1922.

**4666** Branch houses should in general make reports to the parent house, which is liable to make monthly returns of the sales of the branch house. An itinerant manufacturer should make return and pay the tax to the collector of the district where the sales were made.

**4667** The books of every person liable to the tax shall be open at all times for inspection by examining internal-revenue officers. (As to penalties, see Art. 39.)

**4668** The person responsible for the return and payment of the tax shall, in order that returns may be readily checked and verified by examining internal-revenue officers, keep such records and memoranda as will clearly show the amounts of the sales of taxable articles for each month.

**Trade with Possessions of United States**

**4669 Art. 37. Trade with possessions of United States.**—A sale which  
 4539 results in the shipment of articles into the United States from the Virgin Islands is taxable to the same extent as a sale of articles within the United States. Articles going into the Virgin Islands from the United States are free from tax in the United States. The same rules apply to trade with Porto Rico and the Philippine Islands. (See section 1000 of the Revenue Act of 1917, and Section V of the Act of August 4, 1909, as amended by Section IV, Subdivision C, of the Act of October 3, 1913.) The tax attaches, however, to articles shipped to other possessions of the United States, including the Canal Zone. [Same by Title III, Secs. 301 and 302 by Tariff Act of 1922 (Public—No. 318—67th Congress).]

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## Extens' on of Existing Statutes

**4670 Art. 38. Aids to collection of tax.**—In collecting the excise taxes the  
 8000 Commissioner has the benefit of all existing internal-revenue laws.  
 8001 In aid of the enforcement of the statute the Commissioner may re-  
 8002 quire any person to keep specified records, to render returns and  
 statements as directed, to submit himself and his books to examina-  
 tion, and to comply with such regulations as may be prescribed.

## Penalties

**4671 Art. 39. Penalties.**—Any manufacturer who fails to file a return  
 8014 within the time prescribed is liable under section 3176 to a penalty  
 8071 of 25 per cent of the amount of the tax, unless it is shown that the  
 failure to file it was due to a reasonable cause and not to willful neglect.  
**4672** Any manufacturer who willfully files a false or fraudulent return  
 is liable under section 3176 to a penalty of 50 per cent of the amount  
 of the tax.  
**4673** Any manufacturer who fails to pay a tax when due is liable under  
 section 903 to a penalty of 5 per cent of the amount of the tax, together  
 with interest at the rate of 1 per cent per month. (See Art. 36.)  
**4674** In addition to the above, under certain circumstances the penalties  
 provided under section 1302 may also be imposed on any such manu-  
 facturer and also on the officer, partner, or employee whose duty it was to  
 perform the duties in respect of which the violation occurred. (See also sec.  
 906 and Art. 46.)

## Credits and Refunds

**4675 Art. 40. Credits and refunds.**—If a manufacturer overpays the tax  
 4535 due with one monthly return, or if, under section 906 of the statute he  
 8018 overcollects the tax, he may take credit for the overpayment or over-  
 collection against the tax due with a succeeding return. If he over-  
 collects the tax, he shall upon proper application refund the over-collection  
 to the person entitled thereto, even though such amount has already been  
 paid over to the collector of internal revenue and no corresponding credit  
 has yet been secured. In case a credit is claimed, a statement shall be  
 attached to the return setting forth fully the facts regarding alleged over-  
 payment or overcollection. In the case of the overcollection of a tax, no credit  
 for the amount overcollected shall be allowed until the manufacturer making  
 the overcollection submits a sworn statement showing that the tax in each  
 case so overcollected has been returned to the person making the overpayment,  
 that no claim for a refund of any part of such amount has been filed with the  
 collector or commissioner on behalf of any person who paid such amounts,  
 and a complete list of such persons. It should be noted that a credit may be  
 taken under section 1304 only in the case of *overpayment* or *overcollection* as  
 distinguished from an *illegal* or *erroneous* payment or collection.  
**4676** In all cases where a tax has been collected or paid and such collection  
 or payment is alleged to be *illegal* or *erroneous*, it will be necessary for  
 the person so paying the tax to file claim for refund on Treasury Department  
 Form 46 [page 1609]. For procedure with reference to claims for refunds see  
 sections 3220 [§8023.] and 3225 [§8047.] of the Revised Statutes, as amended  
 by sections 1315 and 1323 of the Revenue Act of 1921, and Regulations 14  
 (revised).

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## Exports

**4677** Art. 41. Sales for export.—The tax does not attach to the sale of an  
 4538 article which is sold for export by the manufacturer and in due course so exported.

**4678** An article may be sold for export but never exported or not exported in due course. Also, an article may be exported in due course by the purchaser, although not sold for export.

**4679** In order to be exempt from tax, however, it is necessary that the article be both sold for export by the manufacturer and in due course so exported.

**4680** An article will be regarded as having been sold for export if the manufacturer has in his possession at the time that title passes or of shipment (whichever is prior) (a) an order or contract of sale or document incidental thereto showing in writing that the manufacturer is to ship the article direct to a foreign destination; or (b) where the delivery is to be made to the purchaser or his agent within the United States, a *certificate* from such purchaser or agent, as the case may be, showing (1) that the article is purchased either to fill a firm order then held by such purchaser requiring shipment to a foreign destination, or for shipment (or transportation) by him in due course to himself or to his agent or to his principal in a foreign country, or that the article is purchased to fill future orders calling for shipment thereof by the purchaser direct to a foreign destination, and (2) that the article will be transported to a foreign destination in due course prior to use, resale, or further manufacture within the United States.

**4681** In these cases the manufacturer, for a period of twelve months from the date when title passes or of shipment (whichever is prior), is excused from filing returns for the articles so sold. This temporary exemption becomes permanent upon the manufacturer's attaching to such order, contract, or certificate before the expiration of such period of twelve months due proof of exportation (see Art. 42). On the other hand, if within such period of twelve months the manufacturer has not received and attached to such order or contract such "proof of exportation," then the temporary exemption ceases and the manufacturer shall include a tax on the sale of such article in his return for the month in which such period of twelve months expires. The order or contract of sale and certificate and the "proof of exportation" must be preserved by the manufacturer in such a way as to be readily accessible for inspection by internal-revenue officers. No sale shall be considered to be exempt from tax under section 1305 of the Act, unless its character as an export sale has been established in accordance with the above provisions.

**4682** Art. 42. Proof of exportation.—By the term "proof of exportation" is meant an affidavit of the exporter (who, if not the manufacturer, must be the purchaser from the manufacturer or an agent of one or the other) containing the following information: (1) The name and address of manufacturer; (2) the name and address of the exporter; (3) whether exporter is acting in his own behalf or as agent, and if agent name of principal; (4) a brief description of the article; (5) the date upon which the article was delivered to a carrier for transportation beyond the limits of the United States (or if not transported by carrier the actual date and manner of transportation out of the United States); (6) the name of carrier issuing export bill of lading, and if a carrier by sea, the name of vessel carrying the article and date of departure from United States; (7) destination of article; (8) statement that the article



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was in fact exported in due course prior to use, resale, or further manufacture within the United States.

**4683** Where the manufacturer is the exporter there may be attached to the original contract or order as proof of exportation, in lieu of the affidavit provided for in the preceding paragraph, (1) a copy of export bill of lading, or (2) a certificate by the agent or representative of the export carrier showing exportation of the article, or (3) certificate of mailing, where the article was shipped by parcel post. Where the exportation is accomplished by a person other than the manufacturer, the exporter must carefully preserve in his own files a copy of export bill of lading or other shipping document and all other papers bearing on the transaction, readily accessible for inspection by any authorized official of the United States.

**4684** Where the exportation is accomplished by a person other than the manufacturer, the affidavit above required may cover all the articles received from the manufacturer upon any one contract or shipment, whether exported on different dates or shipped to different consignees.

**4685** In any case where the manufacturer does not have in his possession, within the twelve months' period, proof of exportation as outlined herein, the manufacturer must pay the tax. Whenever proper proof of exportation is available, claim for refund of the amounts so paid may be filed.

## Transfer of Burden of Tax

**4686** Art. 43. Contract of sale prior to August 15, 1921, of article taxed  
4531 under section 900 or 904, 1921 Act, on which no corresponding tax was levied under section 900 of the 1918 Act.—If before August 15, 1921, "A," a manufacturer, made with "B," a dealer, a contract of sale for an article taxed under section 900 or 904 of the Revenue Act of 1921, and in respect to which no corresponding tax was imposed by section 900 of the Revenue Act of 1918, which does not permit the addition of the tax to the amount payable under the contract, then the liability for the tax is on "B," with the duty on "A" only to collect and pay it to the collector as provided in article 46. If, however, "A," before August 15, 1921, made a contract of the character described with any person other than a dealer as defined in article 47, no tax is payable in respect of the sale by him, since on August 15, 1921, no tax was in force on the sale of the articles.

**4687** Art. 44. Contract of sale before August 15, 1921, of article taxable  
4532 under section 900, 1918 Act, at rate greater than tax on same article under section 900, 1921 Act.—If before August 15, 1921, "A," a manufacturer of candy taxable at 5 per cent under section 900 of the Revenue Act of 1918, made a contract with "B," a dealer or not, which included in the price stipulated in the contract the tax under section 900 of the 1918 Act, and the contract does not permit the deduction from the amount to be paid of the difference between the tax at 5 per cent under section 900 of the 1918 Act and the tax at 3 per cent under section 900 of the 1921 Act, "A" must refund to "B" so much of the amount of such difference as is not permitted to be deducted from the contract price. (See articles 40 and 46 as to credits for such refunds.)

**4688** Art. 45. Contract of sale prior to August 15, 1921, of article taxable  
4533 under section 900, 1918 Act, on which no corresponding tax under section 900, 1921 Act.—If before August 15, 1921, "A," a manufacturer of chewing gum, taxable under section 900 of the 1918 Act, but not

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taxable under section 900 of the 1921 Act, made a contract with "B," a dealer or not, which includes in the price stipulated in the contract the tax imposed under section 900 of the 1918 Act, and the contract does not permit the deduction from the amount to be paid of such tax, "A" must refund to "B" so much of the amount of such tax as is not so permitted to be deducted from the contract price. (See articles 40 and 46 as to credit for such refunds.)

**4689 Art. 46. Return of tax.**—Each person receiving any payments referred  
4534 to in section 906 of the statute shall collect the amount of the tax, if any, imposed by such section from the person making such payments, and shall make monthly returns under oath in duplicate and pay the taxes so collected to the collector of the district in which his principal office or place of business is located. If sale is made on credit, other than on conditional sale, the manufacturer shall return the tax at the time of sale, but may defer collection thereof from the purchaser.

**4690** Any person making a refund of any payment upon which the tax is so  
4535 collected may repay therewith the amount of the tax collected on such payment, and if the tax on the sale in respect to which refund is made has been paid to the Government the amount of the tax so repaid to the purchaser may be credited against amounts included in any subsequent monthly return. (See also Art. 40.)

**4691** The return must be made on Form 728 (revised) [page 907] in time to  
be in the office of the collector or zone deputy on or before the last day of the month following the month in which the sale is made, as provided in article 36.

**4692** The tax shall, without assessment by the Commissioner or notice  
from the collector, be due and payable to the collector at the time fixed for filing the return.

**4693** If the tax is not paid when due, there shall be added as a part of the  
tax a penalty of 5 per cent, together with interest at the rate of 1 per cent for each full month from the time when the tax became due.

**4694 Art. 47. Meaning of "dealer."**—The term "dealer" includes not only  
4536 dealers in the ordinary sense—that is, persons engaged in the business of selling articles—but also a person who purchases an article with the intention of using it in the manufacture or production of any article intended for sale. The term does not include a person buying an article for his personal consumption or use. The United States, a State, Territory, or a political subdivision thereof, or a foreign Government, purchasing an article for its own use is not a dealer.

### Fractional Part of Cent

**4695 Art. 48. When fractional part of cent may be disregarded.**—In the  
8019 payment of taxes, a fractional part of a cent may be disregarded unless it amounts to one-half cent or more, in which case it shall be increased to 1 cent.

### Medium of Payment of Tax

**4696 Art. 49. Payment of tax by uncertified checks.**—Collectors may accept  
8020 uncertified checks in payment of excise taxes, provided such checks are collectible at par—that is, for their full amount, without any deduction for exchange or other charges. The collector will stamp on the face of each check before deposit the words, "This check is in payment of an



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obligation to the United States and must be paid at par. No protest," with his name and title. The day on which the collector receives the check will be considered the date of payment so far as the taxpayer is concerned, unless the check is returned dishonored. If one check is remitted to cover two or more persons' taxes, the remittance must be accompanied by a letter of transmittal stating (a) the name of the drawer of the check; (b) the amount of the check; (c) the amount of any cash, money order, or other instruments included in the same remittance; (d) the name of each person whose tax is to be paid by the remittance; (e) the amount of the payment on account of each person; and (f) the kind of tax paid.

**4697 Art. 50. Procedure with respect to dishonored checks.**—If the bank on which any such check is drawn should refuse to pay it at par, the check should be returned through the depository bank and be treated in the same manner as a bad check. All expenses incident to the attempt to collect such a check and the return of it through the depository bank must be paid by the drawer of the check to the bank on which it is drawn, since no deduction can be made from amounts received in payment of taxes. See section 3210 of the Revised Statutes. If any taxpayer whose check has been returned uncollected by the depository bank should fail at once to make the check good the collector should proceed to collect the tax as though no check had been given. A taxpayer who tenders a certified check in payment for taxes is also not released from his obligation until the check has been paid. See chapter 191 of the Act of March 2, 1911 (36 Stats. 965).

**Misrepresentation of Tax**

**4698 Art. 51. Misrepresentation of tax.**—If a manufacturer or other vendor **4537** misrepresents the tax he is guilty of a misdemeanor and is liable to a fine of \$1,000 and to imprisonment for a year. This provision is designed, among other things, to prevent a vendor adding more than the amount of the tax to the price of an article and representing that the increase is due to the tax.

**Authority for Regulations**

**4699 Art. 52. Promulgation of regulations.**—In pursuance of the statute **8009** the foregoing regulations are hereby made and promulgated and all rulings inconsistent herewith are hereby revoked.

D. H. BLAIR,  
*Commissioner of Internal Revenue.*

Approved January 6, 1922 [Released for publication February 1, 1922]:

A. W. MELLON,  
*Secretary of the Treasury.*

**EXCISE TAXES REGULATIONS.****REGULATIONS NO. 48****Relating to the  
EXCISE TAXES****WORKS OF ART AND JEWELRY**

under

**SECTIONS 902 AND 905 OF TITLE IX OF THE REVENUE ACT OF 1921.**

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[T. D. 3279.]

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## EXCISE TAXES REGULATIONS.

## GENERAL PROVISIONS

**4700 Article 1. Basis of tax.**—The tax is measured by the price for which  
4518 the article is sold. It is on the actual sales price of the goods, and  
4528 not on the list price, where that differs from the sales price. If  
the price of a taxable article is increased to cover the tax, the tax is  
on such increased price. Where, however, the tax is billed as a separate  
item, such amount need not be included in the price of the article in computing  
the tax. The tax is payable in respect to a sale made whether or not the  
purchase price is actually collected. A discount for cash or other discount  
made subsequently to the sale can not be deducted in computing the price  
for the purpose of the tax. Where, however, articles are sold over a period  
of time under an agreement for a quantity rebate, the tax, if  
originally computed on the gross price, may be adjusted in the return for  
the month in which the price is finally determined. Commissions to agents  
and other expenses of sale are not deductible from the price. If articles  
are sold and the delivery charges to point of delivery are paid by the purchaser  
as a specific item, or if they are sold delivered at a sum less delivery charges  
to be paid by the purchaser, such charges need not be included as a part  
of the price of the goods; but if the vendor sells goods at a delivered price and  
pays the delivery charges, he is not entitled to make any deduction on account  
of the inclusion in the price of such charges.

**4701 Art. 2. Rescission of sales.**—If articles sold are returned and the  
sale entirely rescinded, no tax is payable, and if paid it may be credited  
against the tax included in a subsequent monthly return. See Article 34.  
If part only of articles sold at one time is returned, and credit or rebate  
allowed by the vendor therefor, the portion of the tax to be credited will be  
only the proportion of the total tax paid which the amount allowed as credit  
or rebate bears to the total sale price of all the articles. If an article is sold  
and thereafter exchanged for another article of a higher price, the purchaser  
paying the difference, the vendor should pay the tax on the second sale, but  
may take as a credit against such tax the proportion of the tax paid on the  
returned article which the amount allowed as a credit for the return of such  
article on the second sale bears to the amount of the purchase price in the  
case of the first sale.

**4702 Art. 3. Tax payable by vendor.**—The tax is to be paid by the vendor  
on all sales made direct by him or through an agent, whether a sales  
agent, broker, or auctioneer. In the case of articles taxable under section  
905, where an article is consigned to a dealer, the taxable sale is that made by  
the consignee, provided the article is sold for consumption or use.

**4703 Art. 4. When tax attaches.**—The tax attaches when the article is  
sold; that is to say, when the title to it passes from the vendor to the  
purchaser. When title passes is a question of fact, dependent upon the  
intention of the parties as gathered from the contract of sale and the attendant  
circumstances. Where goods are segregated from other goods owned by the  
vendor and it is the intention of both the vendor and the purchaser at the  
time the goods are segregated that they shall then belong to the purchaser,  
the title will be presumed to pass at such time. In the absence of any inten-  
tion to the contrary the title is presumed to pass upon delivery of the article  
to the purchaser or to a carrier for the purchaser. In the case of a con-  
ditional sale, where the title is reserved until payment of the purchase price

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in full, the tax attaches (a) upon such payment, or (b) when title passes if before completion of the payments, or (c) when before completion of the payments, the dealer disposes of the sale by charging off by any method of accounting he may adopt the unpaid portion of the contract price, or (d) when the vendor discounts the notes of the purchaser for cash or otherwise, or (e) when the vendor transfers his title in the article sold to another.

**4704 Art. 5. Giving of premiums.**—The giving of so-called “premiums” in return for wrappers, labels, coupons, trading stamps, or other scrip delivered or sold in connection with the sale of a commodity is a sale within the meaning of section 902 and section 905 if the premium is within the class of articles enumerated in those sections. In such cases the tax attaches at the time title in the premium passes to the person receiving it in exchange for such scrip, and is to be computed on the fair market value of the premium at such time. No tax attaches to the gift of an article which if sold would be taxable. Premiums given in return for wrappers, labels, coupons, trading stamps, or other scrip are not considered as gifts.

**4705 Art. 6. Sale to the United States or a State.**—The tax applies to articles enumerated in sections 902 and 905 when sold to the United States, or to a State or political subdivision thereof for use in carrying on its governmental operations.

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**4706 Art. 7. Effective date.**—The tax applies to all sales made on or after January 1, 1922.

**4707 Art. 8. Taxable sales.**—The tax imposed by section 902 is on any sale of the articles enumerated other than a sale by the actual artist, or to an educational institution or public art museum, or by any dealer in such articles to another dealer in such articles, for resale. The tax attaches whether the sale is made directly or through an agent. If made through an agent the tax is payable by the owner, but the agent may make return and pay the tax for the owner. A receiver conducting a business under court order is liable to the tax upon articles sold by him. When a person other than the artist consigns articles, retaining ownership in them until they are disposed of by the consignees, such person must pay the tax upon all such goods sold by the consignee.

**4708 Art. 9. Taxable sales: Examples.**—The tax applies to all sales from private owner to private owner, or from private owner to dealer, or from dealer to private owner, and the tax to be paid upon each such sale is to be reckoned upon the full amount of the price for which the article was sold. For example, a picture is sold by a private owner to a dealer for \$10,000; the private owner must pay a tax of 5 per cent of \$10,000, or \$500, but if this picture is thereafter sold to another dealer for \$15,000, and the second dealer in turn sells the picture to a third dealer for \$20,000, no tax is payable on such sales by one dealer to another for the purpose of resale. However, if the third dealer sells the painting to a private collector for \$25,000, the third dealer must pay a tax of 5 per cent of \$25,000, or \$1,250. Should the private owner sell it to another private owner for \$30,000, the former must pay a tax of 5 per cent of \$30,000, or \$1,500.



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**4709 Art. 10. Sales by the artist.**—Sales by the artist are not taxable.

By "artist" is meant the individual who by his own hands, completely or as to the important part so far as the article's artistic merit is concerned, produces the article. The artist's sale may be made directly or through a dealer, commission merchant, or other person. The exempt sale is only the original sale by the artist. If the artist regains title to an article and again sells it, such sale is taxable.

**Sculpture**

**4710 Art. 11. Articles taxed: Sculpture.**—The term "sculpture" means

any production (whether antique or modern, and whether original, replica, copy, or reproduction) which is cut or carved by hand from marble, stone, alabaster, agate, crystal, jade, lapis lazuli, or other semiprecious stone, terra cotta, ivory, bone, wood, clay, wax, metal, or any other substance, and which is of such a character that the use to which under general custom or ordinary usage it should be put (irrespective of the use to which the purchaser intends to put it) is entirely or principally an ornamental or decorative one as distinguished from a useful or utilitarian one. The following list, not intended to be exhaustive, is given to show the class of articles embraced within this definition, viz: Statues, statuettes, figures, figurines, groups, busts, haut or bas-reliefs, plaques, pedestals, vases, flower bowls, or holders, jardinières, brackets, fountains, sundials, book ends, paper weights, cabinet pieces or curios, and the numerous articles included within the term bric-a-brac, when such articles are cut or carved by hand. The term "sculpture" shall not be understood to include (a) such articles as are in the nature of material, work, or labor furnished in connection with the erection or construction of a building and which form an integral part thereof, or (b) cut glassware, or engravings on metal, wood, shell, stone, or other substance, or (c) furniture, altars, candlesticks, chandeliers, railings, gates, doors, memorial monuments, tombstones, or other articles designed primarily for a useful purpose.

**Paintings**

**4711 Art. 12. Articles taxed: Paintings.**—The terms "paintings" means

any pictures, images, likenesses, scenes, designs, or sketches, wholly or in part in oil, mineral, water, or other colors on canvas or other textile, wood, paper, metal, plaster, or other material, (a) whether antique or modern, (b) whether originals, replicas, copies, or reproductions, and (c) whether or not intended for reproduction by printing or other processes. The term "paintings" shall not be understood to include (1) such as are in the nature of work or labor furnished in connection with the erection or construction of a building and which form an integral part thereof; (2) furniture, windows, tableware, toilet articles, glove, handkerchief, candy, or other fancy boxes, menu, place, greeting, and similar cards, stationery, candlesticks, signs, placards, desk fittings, and other articles of utility when the same are ornamented or decorated with oil, mineral, water, or other colors; (3) such as are produced wholly or in part by stenciling, printing, or other mechanical process; and (4) pastels or drawings. The term "drawings" as used in this article shall include only pictures, images, likenesses, scenes, designs, or sketches produced by means of lines.

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## Statuary

**4712 Art. 13. Articles taxed: Statuary.**—The term “statuary” means any production (whether anique or modern and whether original, replica, copy, or reproduction) cut, carved, or otherwise wrought by hand from marble, stone, alabaster, agate, crystal, jade, lapis lazuli, or other semi-precious stone, terra cotta, ivory, bone, wood, clay, wax, metal, or other substance, when such production is a representation in the round of the human or animal form (irrespective of size), whether real, mythical, fabulous, or allegorical. The term “statuary” shall not be understood to include (a) such productions as are in the nature of material, work, or labor furnished in connection with the erection or construction of a building and which form an integral part thereof, (b) dolls or toys, or (c) such productions as are designed for a primarily useful purpose.

## Art Porcelains

**4713 Art. 14. Articles taxed: Art porcelains.**—The term “art porcelains” means that class of articles, such as statues, statuettes, figures, figurines, groups, busts, haut or bas-reliefs, plaques, pedestals, vases, flower bowls or holders, jardinières, brackets, fountains, sundials, cabinet pieces or curios, and the numerous articles included within the term bric-a-brac by whatever process made (except as provided in the following paragraph) when such articles are made wholly or in chief value (a) of any ceramic production of translucent ware, of hard or soft paste, whether vitrified or semi-vitrified, by whatever name known; or (b) of that which is commonly or commercially known as porcelain, in either case, whether or not decorated, colored, or ornamented, whether modern or antique, and whether originals, replicas, copies, or reproductions, which are of such a character that the use to which under general custom or ordinary usage they should be put (irrespective of the use to which the purchaser intends to put them) is entirely or principally an ornamental or decorative one as distinguished from a useful or utilitarian one.

**4714** The term “art porcelains” shall not be understood to include (a) such articles as are in the nature of material, work, or labor furnished in connection with the erection or construction of a building and which form an integral part thereof, (b) tableware or other articles designed for a primarily useful purpose, or (c) such articles as are duplicated by the manufacturer in commercial quantity wholly or chiefly by the ordinary mechanical processes of manufacture. Articles shall not be deemed to be duplicated in commercial quantity if they are ordinarily sold by the manufacturer in quantities of less than a dozen.

## Bronzes

**4715 Art. 15. Articles taxed: Bronzes.**—The term “bronzes” means that class of articles covered by “sculpture” and “statuary” as defined in articles 11 and 13 by whatever process made, when such articles are made wholly or in chief value of that substance which is commonly or commercially known as bronze, whether such articles are modern or antique, and whether originals, replicas, copies, or reproductions, which are of such a character that the use to which under general custom or ordinary usage they should be put (irrespective of the use to which the purchaser intends to put them) is entirely or principally an ornamental or decorative one as distinguished from a useful or utilitarian one. The term “bronzes” shall not be understood to include (a) architectural bronzes, (b) such articles as are in the nature of



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material, work, or labor furnished in connection with the erection or construction of a building and which form an integral part thereof, (c) medals, memorial or commemorative tablets, or (d) such articles as are designed for a primarily useful purpose. The sale to an artist by a foundry of a casting made from the artist's model is not subject to the tax.

## Frames

**4716 Art. 16. Articles taxed: Frames.**—If a taxable article is sold in a frame, the tax attaches to the price for which both the article and the frame are sold. If, however, the article is sold without the frame, the tax applies only to the price at which the article itself is sold. The frame, however, if sold separately, may be taxable under section 905 of the Revenue Act of 1921.

## JEWELRY

**4717 Art. 17. Effective date.**—The tax is effective as to all sales made on or after January 1, 1922.

**4718 Art. 18. Use of terms.**—For the purpose of the tax and as used in these regulations, the term "dealer" means any individual, partnership, association, or corporation engaged in the business of selling for profit any of the enumerated articles to a purchaser for consumption or use, and the estate of such a dealer. Thus, a dealer may be a manufacturer, jobber, wholesaler, retailer, mail-order house, installment house, trustee in bankruptcy, receiver, pawnbroker, or peddler, if the sale is for consumption or use; but a casual sale, not in the course of trade or business, by an individual of any of the enumerated articles, does not constitute the vendor a "dealer" within the meaning of section 905. An auctioneer or broker is a dealer within the meaning of the act in respect to all sales made by him of articles in which he has title, but not in respect to articles which he is selling as an agent.

**4719 Art. 19. Articles tax paid under other acts.**—The tax is on the sale by or for a dealer or his estate when any of the enumerated articles are sold for consumption or use, whether or not a tax under any other law has been previously paid on such articles.

**4720 Art. 20. Consumption or use.**—An article is sold "for consumption or use" within the meaning of section 905 of the act if it is sold for any other purpose than to be sold, leased, or otherwise disposed of for profit, whether or not after change in form by process of manufacture.

**4721** Unless the purchaser is a wholesaler, retailer, or manufacturer customarily engaged in the business of selling or further manufacturing the articles in respect to which the applicability of the tax is in question, the sale to such purchaser will be deemed to be for consumption or use, unless the contrary is clearly shown.

## Common or Commercial Jewelry

**4722 Art. 21. Jewelry.**—The following articles are taxable as jewelry:

**4723** (1) Articles to be worn on the person or apparel for purpose of adornment, which according to general custom or ordinary usage are worn so as to be displayed, such as brooches, rings, chains, cuff buttons, necklaces,

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fobs, and shoe buckles. Such articles are taxable regardless of the substance of which made (except as provided in subdivision (1) of article 22), and regardless of their utilitarian value.

**4724** The term "worn on the person" as used in this paragraph does not include articles to be carried in the hand or hung over the arm, such as bags or purses.

**4725** (2) Articles to be carried in the hand, or hung on the arm, or carried or worn concealed on the person, whether in pocket or bag or under the outer garment, such as cigarette cases, eyeglass cases, pencils, powder boxes, garter buckles, purses or hand bags. Such articles are taxable *as jewelry* only if made of or ornamented, mounted or fitted with pearls, precious or semiprecious stones, or imitations thereof; but if so made, ornamented, mounted, or fitted, they are taxable regardless of their utilitarian value. See also article 24.

**4726** (3) Articles not taxable under the following articles may be taxable by reason of being articles commonly or commercially known as jewelry, real or imitation. It should be carefully noted that the rulings in this article are only as to articles taxable *as jewelry*. Articles which are not taxable as jewelry may be taxable under articles 23 or 24. Thus a cigarette case, if made of, or ornamented, mounted, or fitted with a precious metal or imitation thereof, although not taxable under this article is taxable under article 24. It should also be noted that the examples given in this article are not intended to be exhaustive, but merely illustrative.

**Articles Not Taxable**

**4727** **Art. 22. Articles not taxable.**—(1) The following articles of personal adornment are not taxable under section 905, unless ornamented, mounted or fitted with pearls, precious or semi-precious stones, or imitations thereof: (a) Articles made of textiles or feathers; (b) hat trimmings (not including hatpins); (c) shoe trimmings (not including buckles); (d) buttons ordinarily worn permanently attached to wearing apparel.

**4728** (2) Articles used as ornaments for wearing apparel are taxable if coming within the classification of subdivision (1) or (2) of article 21, or if within the provisions of any of the following articles:

**Pearls, Stones, and Imitations**

**4729** **Art. 23. Pearls, precious and semiprecious stones and imitations thereof.**—The tax attaches to the sale of all pearls and precious or semiprecious stones, whether real or imitation, cut or uncut, whether or not drilled, mounted, or matched, and whether or not temporarily or permanently strung, and whether with or without clasps.

**Articles Made of Precious Metals or Imitations or Ivory**

**4730** **Art. 24.**—Articles made of, or ornamented, mounted or fitted with precious metals or imitations thereof or ivory.—The term "precious metals" includes silver, gold, platinum, and all metals more valuable than these. The term "imitations thereof" includes only platings or alloys of any of the above materials.

**4731** The following articles are not taxable under the clause of section 905 construed in this article: (1) Articles made of imitation ivory; (2) surgical instruments, eyeglasses and spectacles; (3) articles merely ornamented or overlaid with gold or silver leaf or paint, such as picture frames, books, and Christmas cards.

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**4732** Glassware, china, pottery, and like articles are only taxable if ornamented, mounted or fitted with precious metals or imitations thereof, but are not taxable when ornamented with gold or silver leaf or paint.

**4733** It should be carefully noted, however, that the articles above enumerated, although not taxable as "articles made of, or ornamented, mounted, or fitted with, precious metals or imitations thereof or ivory," may be taxable as jewelry. Thus a hatpin with a head of imitation ivory is taxable as jewelry. For articles taxable as jewelry see article 21.

**4734** Shoe buckles not attached to shoes are taxable as jewelry under section 905, regardless of the material of which made, if they are ornamented, mounted, or fitted with pearls, precious or semi-precious stones, or imitations thereof. Shoe buckles made of or ornamented, mounted or fitted with precious metals or imitations thereof, or ivory, are taxable under section 905.

**4735** Fountain pens equipped with gold pen points are taxable on the total price for which such pens are sold.

**Watches and Clocks**

**4736** **Art. 25. Watches and clocks.**—Watch or clock movements sold separately are taxable. Watch or clock cases sold separately are taxable when made of or ornamented, mounted, or fitted with precious metals or imitations thereof or genuine ivory. Watches and clocks sold complete are taxable regardless of the substance of which made. Watch or clock cases and movements sold separately, but intended to be used together, are taxable.

**4737** **Art. 26. Opera glasses, lorgnettes, marine glasses, field glasses, and binoculars.**—The enumeration in the statute includes only portable instruments. Instruments of the character enumerated, which by reason of their size or weight are ordinarily mounted upon tripods or other bases, are not taxable.

**Second-hand Articles**

**4738** **Art. 27. Second-hand articles.**—Articles coming within the enumeration of section 905 are not exempt from taxation when sold by a dealer for consumption or use at second-hand or after being used, but are taxable on the price for which sold.

**Repairs**

**4739** **Art. 28. Repairs.**—Ordinary repairs which do not increase the value of the article repaired are not taxable, but repairs involving the addition of precious metals or imitations thereof, or ivory, are taxable upon the price of the added parts, which will be presumed to be the price charged for the job, unless the contrary is shown.

**4740** Repairs which are merely such as to put the article in a serviceable condition as originally sold and which do not increase the original value of the article repaired, even though such repairs involve the addition of precious metals or imitations thereof, or ivory, are not taxable under section 905. However, repairs involving the addition of precious metals or imitations thereof, or ivory, not falling in the above class, or pearls, precious and semiprecious stones and imitations thereof, are taxable upon the price of the added parts, which will be presumed to be the price charged for the job unless the contrary is shown.

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## ADMINISTRATIVE PROVISIONS

## Exports

**4741** Art. 29. Sales for export.—The tax does not attach to the sale of  
**4538** an article which is sold for export by the vendor, and in due course  
 so exported.

**4742** An article may be sold for export but never exported, or not exported  
 in due course; also, an article may be exported in due course by  
 the purchaser, although not sold for export.

**4743** In order to be exempt from tax, however, it is necessary that the  
 article be both sold for export by the vendor and in due course so  
 exported.

**4744** An article will be regarded as having been sold for export if  
 the vendor has in his possession at the time that title passes or of  
 shipment (whichever is prior) (a) an order or contract of sale or document  
 incidental thereto showing in writing that the vendor is to ship the article  
 direct to a foreign destination; or (b) where the delivery is to be made to the  
 purchaser or his agent within the United States, a *certificate* from such pur-  
 chaser or agent, as the case may be, showing (1) that the article is purchased  
 either to fill a firm order then held by such purchaser requiring shipment to a  
 foreign destination, or for shipment (or transportation) by him in due course  
 to himself or to his agent or to his principal in a foreign country, or that the  
 article is purchased to fill future orders calling for shipment thereof by the  
 purchaser direct to a foreign destination, and (2) that the article will be trans-  
 ported to a foreign destination in due course prior to use, resale, or further  
 manufacture within the United States.

**4745** In these cases the vendor, for a period of 12 months from the date  
 when title passes or of shipment (whichever is prior), is excused from  
 filing returns for the articles so sold. This temporary exemption becomes  
 permanent upon the vendor's attaching to such order, contract, or certificate  
 before the expiration of such period of 12 months due proof of exportation  
 (see Art. 30). On the other hand, if within such period of 12 months the  
 vendor has not received and attached to such order or contract such "proof  
 of exportation," then the temporary exemption ceases and the vendor shall  
 include a tax on the sale of such article in his return for the month in which  
 such period of 12 months expires. The order or contract of sale and certifi-  
 cate and the "proof of exportation" must be preserved by the vendor in such  
 a way as to be readily accessible for inspection by internal-revenue officers.  
 No sale shall be considered to be exempt from tax under section 1305 of the  
 act unless its character as an export sale has been established in accordance  
 with the above provisions.

**4746** Art. 30. Proof of exportation.—By the term "proof of exportation"  
 is meant an affidavit of the exporter (who, if not the vendor, must  
 be the purchaser from the vendor or an agent of one or the other) containing  
 the following information: (1) The name and address of vendor; (2) the name  
 and address of the exporter; (3) whether exporter is acting in his own behalf  
 or as agent, and if agent name of principal; (4) a brief description of the  
 article; (5) the date upon which the article was delivered to a carrier for  
 transportation beyond the limits of the United States (or if not transported  
 by carrier the actual date and manner of transportation out of the United  
 States); (6) the name of carrier issuing export bill of lading, and if a carrier  
 by sea, the name of vessel carrying the article and date of departure; from



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United States; (7) destination of article; (8) statement that the article was in fact exported in due course prior to use, resale, or further manufacture within the United States.

**4747** Where the vendor is the exporter there may be attached to the original contract or order as proof of exportation, in lieu of the affidavit provided for in the preceding paragraph, (1) a copy of export bill of lading, or (2) a certificate by the agent or representative of the export carrier showing exportation of the article, or (3) certificate of mailing, where the article was shipped by parcel post. Where the exportation is accomplished by a person other than the vendor the exporter must carefully preserve in his own files a copy of export bill of lading or other shipping document and all other papers bearing on the transaction, readily accessible for inspection by any authorized official of the United States.

**4748** Where the exportation is accomplished by a person other than the vendor, the affidavit above required may cover all the articles received from the vendor upon any one contract or shipment, whether exported on different dates or shipped to different consignees.

**4749** In any case where the vendor does not have in his possession, within the 12-months' period, proof of exportation as outlined herein, the vendor must pay the tax. Whenever proper proof of exportation is available, claim for refund of the amounts so paid may be filed.

### **Trade with Possessions of the United States**

**4750** **Art. 31. Trade with the possessions of the United States.**—Section 1304 of the revenue act of 1918 provides as follows:

That there shall be levied, collected, and paid in the United States, upon articles coming into the United States from the Virgin Islands, a tax equal to the internal-revenue tax imposed in the United States upon like articles of domestic manufacture; such articles shipped from such islands to the United States shall be exempt from the payment of any tax imposed by the internal-revenue laws of such islands: *Provided*, That there shall be levied, collected, and paid in such islands, upon articles imported from the United States, a tax equal to the internal-revenue tax imposed in such islands upon like articles there manufactured; and such articles going into such islands from the United States shall be exempt from payment of any tax imposed by the internal-revenue laws of the United States.

**4751** A sale which results in the shipment of articles into the United States from the Virgin Islands is taxable to the same extent as a sale of articles within the United States. Articles going into the Virgin Islands from the United States are free from tax in the United States. The same rules apply to trade with Porto Rico and the Philippine Islands. See section 1000 of the revenue act of 1917 and Section V of the act of August 4, 1909, as amended by Section IV, subdivision C, of the act of October 3, 1913. The tax attaches, however, to articles shipped to other possessions of the United States, including the Canal Zone. [See note at end of ¶4669.]

### **Return and Payment of Tax**

**4752** **Art. 32. Return and payment of tax.**—In accordance with the law sections here cited, every person liable for the tax in respect to the sale of any of the articles enumerated in section 902 or section 905 must make monthly returns under oath in duplicate (except that if the amount of tax covered thereby is not in excess of \$10 such returns may be signed and acknowledged before two witnesses instead of under oath), and pay the taxes imposed on such articles to the collector of

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internal revenue for the district in which his principal place of business is located. If he has no place of business, return should be made to the collector for the district in which he resides. An itinerant dealer should make return and pay the tax to the collector of the district where the sales are made. The returns shall be made on Form 728A (Revised) [see page 909]. Instructions for preparing the return will be found on the back of the form. The returns are to be rendered and the tax paid on or before the last day of each month covering the transactions of the preceding month. The first return must cover all transactions from January 1 to January 31, 1922, both inclusive, and is to be made on or before February 28, 1922. The books of every person liable to the tax shall be open at all times for inspection by examining internal-revenue officers.

**Returns By Agents**

**4753 Art. 33. Returns by agents.**—Every auctioneer, agent, factor, broker, dealer, or other person selling any of the articles enumerated in section 902, as agent for the owner, unless such owner is the artist, shall make monthly return under oath to the collector for the district in which his principal place of business is located, stating as to each article sold for any such owner the name and address of such owner, the date and amount of the sale, and a brief description of the article.

**Credits and Refunds**

**4754 Art. 34. Credits and refunds.**—If a person overpays the tax due with one monthly return, he may take credit for the overpayment against the tax due with a succeeding return. For the procedure with reference to claims for refund see Regulations No. 14 (revised) and sections 1315 and 1323 of the revenue act of 1921, reenacting sections 3220 [¶8023] and 3225, [¶8047] of the Revised Statutes, as amended.

**Fractional Part of Cent**

**4755 Art. 35. Fractional part of cent.**—In computing the tax a fractional part of a cent shall be disregarded unless it amounts to one-half cent or more, in which case it shall be increased to a full cent.

**Penalties**

**4756 Art. 36. Penalties.**—[See ¶4520, ¶4530, ¶4537, ¶8014, ¶8073, ¶8074.]

**Authority for Regulations**

**4757 Art. 37. Promulgation.**—In pursuance of the statute the foregoing regulations are hereby made and promulgated and all rulings inconsistent herewith are hereby revoked.

D. H. BLAIR,

*Commissioner of Internal Revenue.*

Approved January 12, 1922 [Released for publication February 1, 1922]:

A. W. MELLON,

*Secretary of the Treasury.*



**EXCISE TAXES: REGULATIONS:**

(Decision.)

February 7, 1923.

One who purchases automobile trucks and bodies from the respective manufacturers thereof and after installing a body on a chassis sells the combination at retail is a manufacturer of an automobile truck within the meaning of the Act and is liable to tax as such.

IN THE UNITED STATES CIRCUIT COURT OF APPEALS

FOR THE NINTH CIRCUIT

R. C. KLEPPER, doing business under the fictitious name of

Bethlehem Motors Company, Plaintiff in Error.

vs.

No. 23887

JOHN P. CARTER, Collector of Internal Revenue, Southern

District of California, Defendant in Error.

Writ of Error to the United States District Court for the Southern District of California, Southern Division.

Before GILBERT, ROSS and HUNT, Circuit Judges.

**4758** This case involves the legality of certain taxes paid by the plaintiff in error for the year 1919.

**4759** Klepper, doing business under the fictitious name of Bethlehem Motors Company was a retail dealer in automobile trucks. The Bethlehem Motors Corporation of Pennsylvania was a manufacturer of automobile trucks with and without bodies, and sold bodies separately or bodies and chassis assembled. The Weber Auto Body and Trailer Works was a manufacturer of automobile truck bodies, but did not manufacture automobile trucks or chassis; Klepper at various times in 1919 bought automobile trucks from the Bethlehem Motors Corporation. The trucks were equipped with cabs, but the bodies were made by and purchased from the Weber Auto Body and Trailer Works, as such bodies were needed. Klepper sold the completed trucks at retail. The Bethlehem Corporation of Pennsylvania paid the war tax on the thirteen trucks at three per cent on the price for which the trucks were sold to Klepper, and added the amount of the tax to the invoice price, and Klepper paid to the Bethlehem Corporation the amount of such tax. The Weber Company paid the war tax on thirteen bodies at five per cent of the price at which the bodies were sold to Klepper and added the amount of the tax to the invoice price, and Klepper paid to the Weber Company the amount of such tax.

**4760** Carter, as collector of internal revenue, demanded that Klepper pay an additional war tax of three per centum as a manufacturer, on the gross sales price for which Klepper sold the completed automobile trucks to his customers, with added penalties because of Klepper's failure to report such tax as a manufacturer. The collector, however, deducted the amount of tax paid by Klepper to the Bethlehem Corporation and to the Weber Company.

**4761** In due course suit was brought, judgment went against Klepper and writ of error was brought.

**4762** Section 900 of the Act of Congress approved February 24, 1919, chapter 18, provides for the levy, assessment and collection and payment upon designated articles sold by manufacturers, producers or importers, of a tax equivalent to the following percentages of the price for which so sold

or leased: (1) Automobile trucks and automobile wagons, including tires, inner tubes, parts and accessories therefor, sold on or in connection therewith, or the sale thereof, three per centum. (3) Tires, inner tubes, parts or accessories for any of the articles enumerated in subdivision 1 or 2, sold to any person other than a manufacturer or producer of any of the articles enumerated in subdivision 1 or 2, five per centum. Section 903 provides for the making of returns in accordance with the regulations and for adding a penalty if the tax is not paid when due. By regulations of the commissioner of internal revenue, revised in December, 1920, a manufacturer may take as a credit against the tax imposed on him, in respect to the sale of any article taxable under section 900, which he has reimbursed to the manufacturer from whom he purchased any article forming a component part (whether or not changed in form by process of manufacture) of the article sold by him and in respect to which tax is paid by him, provided the tax was billed to him as a specific item and in the exact amount of the tax. Credit is not allowed unless: (1) the article forms a component part of an article sold by such manufacturer and in respect to which a tax is payable by him; (2) such manufacturer has not, in fact, reimbursed the manufacturer from whom he purchased, and has himself in fact paid the tax upon which such credit is sought. Article 7 defines a manufacturer as generally a person who (1) actually makes a taxable article; or (2) by changes in the form of an article produces a taxable article; or (3) by the combination of two or more articles produces a taxable article. The regulations give examples, including "Example 2: A, an automobile body manufacturer sells an automobile body in a knockdown condition, but complete as to all its component parts, to B, a dealer, who assembles these component parts into a complete usable automobile body, and installs it or causes it to be installed on a chassis, which he has purchased from a manufacturer, who is a different person from the manufacturer of the body, and sells the completed automobile. A is the manufacturer of the automobile body, but may sell the same to B tax free under the certificate provided for in article 14. B is the manufacturer of the automobile and subject to tax on the selling price of the completed automobile, but may take credit for the amount of the tax paid by the manufacturer of the chassis."

**4763** HUNT, Circuit Judge, after stating the facts:—In our opinion Klepper was properly held to be a manufacturer or producer of automobile trucks. While he did not make any of the several parts, nevertheless, he bought the parts made by others and he sold a completed automobile truck. The fact that several different concerns did for him, a retail salesman, what, under the prevailing method the purchaser may have had to do for himself, does not affect the question.

**4764** We are not going too far when we recognize that the commonly known general method of transacting the automobile truck business, was for a person to buy a chassis from one dealer or maker, and a body from another, and then to assemble the two. Klepper saved the purchaser all this trouble and made it his business to retail the product of his purchases as an automobile truck. Thus he produced or manufactured the truck. (*Rech-Marbaker Co. vs. Lederer*, Collector, 263 Fed. 593; *Foss Hughes Co. v. Lederer*, Collector, . . . Fed. . . .). In *Carbon Steel Co. vs. Llewellyn*, 251 U. S. 501, the Supreme Court considered an excise tax on the manufacture of shells measured by the sale price. The petitioner in the case asked for a



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rebate on the ground that he did not manufacture, but that the shells were manufactured by independent contractors. The Court held that the purchase of elemental parts of a completed product, or the doing of subsidiary work by a subcontractor did not take from the contractor the character of a "person manufacturing," as comprehended in sec. 301 of the Munitions Tax Act of September 8, 1916, Title III, 463, 39 St. 780.

**4765** The decisions cited support us in the view that plaintiff manufactured or produced and sold complete trucks and that the judgment was right.

*Affirmed.*

(T. D. 3469)

**4766 Smokers' Articles: Humidors.**—The first sentence of Article 27 of Regulations 47 and Regulations 47 (Revised December, 1920) and Article 22 of Regulations 47 (Revised December, 1921), in order to eliminate the words "A device for maintaining moist atmosphere in any receptacle used for holding tobacco products" is amended to read as follows:

"For the purpose of the tax a humidior is a portable receptacle used for holding tobacco products and fitted with a device for maintaining moist atmosphere therein." (T. D. 3469, signed by Commissioner D. H. Blair, and dated April 21, 1923.)

(*Decision.*)

Revenue Act of 1917.

April 23, 1923.

Sale of articles under the Revenue Act of 1917 to domestic commission merchants for export on firm order, and under conditions stated, constitutes a tax-free sale as of articles exported.

SUPREME COURT OF THE UNITED STATES.

A. G. SPALDING & BROS., Plaintiff in Error,

vs.

WILLIAM H. EDWARDS, Collector of Internal Revenue for the Second District of New York.

**4767** Mr. Justice HOLMES delivered the opinion of the Court.

**4677** This is a suit to recover the amount of taxes collected by duress  
**4741** under color of the War Revenue Act of October 3, 1917, c. 63, §600 (f), 40 Stat. 300, 316. The plaintiff, a corporation, manufacturer of the goods in question, says that the tax was laid on articles exported from a State, (New York), in violation of Article I, Section 9, of the Constitution of the United States. Upon demurrer the complaint was dismissed by the District Court on the merits.

**4768** The tax is 'upon all baseball bats . . . balls of all kinds . . . sold by the manufacturer, producer, or importer' and was levied on three occasions admitted to be similar, so that the statement of one transaction will be enough. Delgado & Cia., a firm in the city of La Guaira, Venezuela, ordered Scholtz & Co., commission merchants in New York, to buy for their account and risk a certain number of baseballs and

baseball bats, etc., at an agreed price and to mark the packages "D. & C.: S: La Guaira: No. 36" to indicate the purchasers and their place. Scholtz & Co. thereupon sent to the plaintiff in writing, dated December 10, 1918, this: "Export order from Scholtz & Co., Shipping and Commission Merchants . . . . . Please ship on or before the . . . . . per steamer . . . . . Rush . . . . . Errors in weight often entail heavy fines in foreign Customs houses, therefore be careful when weighing and marking goods, as we shall hold you responsible for any fines caused through your errors. Cases or crates must be made to fit goods as duty is paid by gross weight. Shipping mark and number to be put on packages. (As above, with statement of the goods wanted.) Please send Memo. Invoice at once so we can apply for license and clear at Custom House." Scholtz & Co., instructed the plaintiff to deliver the packages so marked to the Atlantic & Caribbean Steam Navigation Co., an exporting carrier in New York. The plaintiff marked and delivered the goods as directed and was given a receipt by the carrier which it sent to Scholtz & Co. and which was exchanged by them for an export bill of lading in their name, dated February 10, 1919. The goods were transported and delivered in due time to Delgado & Cia. Scholtz & Co. paid the plaintiff on February 1 and were paid their commission by Delgado & Cia. in ninety days from date of shipment. The transaction from start to finish was understood and intended by the plaintiff and Scholtz & Co. to be for the purpose of exporting the goods to Delgado & Cia. in Venezuela. The question is whether the sale was a step in exportation, assuming as appears to be the fact, that the title passed at the moment when the goods were delivered into the carrier's hands.

**4769** The fact that the law under which the tax was imposed was a general law touching all sales of the class, and not aimed specially at exports, would not help the defendant if in this case the tax was "laid on articles exported from any State," because that is forbidden in terms by the Constitution. Article I, Section 9. *United States v. Hvoslef*, 237 U. S. 1, 18. *Crew Levick Co. v. Pennsylvania*, 245 U. S. 292. Articles in course of transportation cannot be taxed. *William E. Peck & Co. v. Lowe*, 247 U. S. 165, 173. So we return to the question that we have stated. To answer it with regard to any transaction we have to fix a point at which, in view of the purpose of the Constitution, the export must be said to begin. As elsewhere in the law there will be other points very near to it on the other side, so that if the necessity of fixing one definitely is not remembered, any determination may seem arbitrary. In this case, for instance, while the goods were in process of manufacture they were none the less subject to taxation if they were intended for export and made with specific reference to foreign wants. *Cornell v. Coyne*, 192 U. S. 418. *Heisler v. Thomas Colliery Co.*, November 27, 1922. On the other hand no one would doubt that they were exempt after they had been loaded upon the vessel for Venezuela and the bill of lading issued. It seems to us that the facts recited are closer to the latter than to the former side, and that the export had begun.

**4770** The very act that passed the title and that would have incurred the tax had the transaction been domestic, committed the goods to the carrier that was to take them across the sea, for the purpose of export and with the direction to the foreign port upon the goods. The expected and accomplished effect of the act was to start them for that port. The fact that further acts were to be done before the goods would get to sea does not matter so long as they were only the regular steps to the contemplated result.



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Getting the bill of lading stands no differently from putting the goods on board ship. Neither does it matter that the title was in Scholtz & Co. and that theoretically they might change their mind and retain the bats and balls for their own use. There was not the slightest probability of any such change and it did not occur. The purchase by Scholtz & Co. was solely for the purpose of Delgado & Cia. and for their account and risk. Theoretical possibilities may be left out of account. In *Railroad Commission of Louisiana v. Texas & Pacific Ry. Co.*, 229 U. S. 336, the consignees might have retained the goods at New Orleans instead of shipping them abroad. The fact that they came to New Orleans by rail from another place in the State made no difference. The same principle was applied in *Texas & New Orleans R. R. Co. v. Sabine Tram Co.*, 227 U. S. 111, 123. The overt act of delivering the goods to the carrier marks the point of distinction between this case and *Cornell v. Coyne*, 192 U. S. 418. To put it at any later point would fail to give to exports the liberal protection that hitherto they have received; of which an example may be seen in *Thames & Mersey Marine Ins. Co., Ltd. v. United States*, 237 U. S. 19.

Judgment reversed.

(T. D. 3485.)

**4771** **Time for filing returns and payment of sales taxes.**—The sixth sentence of Article 41, Regulations 43, (Part 1); the fifth sentence of Article 13, Regulations 43, (Part 2); the fourth sentence of Article 36, Regulations 47; the sixth sentence of Article 32, Regulations 48; the first sentence of Article 20, Regulations 52; and the second sentence of Article 35, Regulations 57, are hereby amended by inserting a comma at the end thereof, and adding the following: "except that when the last day of the month in which a return and payment are due falls on Sunday or a legal holiday, the return may be filed and payment made to the Collector of Internal Revenue or Deputy Collector on the next secular or business day." (T. D. 3485, signed by Commissioner D. H. Blair, and dated June 1, 1923.)

(T. D. 3495.)

*Sections 313, 315 and 600 of the Revenue Act of October 3, 1917.*

**4772** **Sales of articles exported—Modification of T. D. 2739 and T. D. 2781.**—In view of the recent decision of the Supreme Court in the case of *Spalding and Bros. v. Edwards*, 43 Sup. Ct. 485 (T. D. 3476) [4767], all prior rulings with respect to the tax paid under Sections 313, 315 and 600 of the Revenue Act of October 3, 1917, on sales by the manufacturer of articles exported to a foreign country are hereby modified to conform to the ruling laid down in that decision.

**4773** Section 600 imposes a tax in respect of automobiles and other enumerated articles and Sections 313 and 315 in respect of nonalcoholic beverages and other enumerated articles sold by the manufacturer, producer, or importer. Section 9 of Article I of the Constitution of the United States provides that "no tax or duty shall be laid on articles exported from any State."

**4774** The determining circumstance with respect to whether or not the sale of an article is exempt from taxation under the above Section of the Constitution is whether or not the sale was a step in the exportation of the article to its real and ultimate destination in a foreign country. If the

## EXCISE TAXES REGULATIONS.

sale and delivery by the manufacturer actually start the article to its destination in a foreign country, either by the immediate carrier or through connecting carriers the sale is exempt from taxation, and the fact that further acts are to be done before the goods get to sea does not matter so long as they are only the regular steps to the contemplated result—exportation. It is not necessary that shipment be upon through bills of lading.

**4775** In the cases where a manufacturer sells an article to a domestic purchaser not engaged exclusively in the export business and who at the time of the sale has no contract with foreign purchasers for the fulfillment of which the purchase is made, such sales are subject to tax even though the article is ultimately exported. A sale to a concern doing business in the United States is a sale for domestic delivery unless compliance with the terms of the order or contract of sale results in starting the article on its course for delivery in a foreign country.

**4776** Articles normally may be exported by the manufacturer tax free in several ways: (1) They may be shipped by the manufacturer to an agent in a foreign country and after reaching there may be sold by the agent; (2) they may be shipped by the manufacturer to a foreign purchaser to fill orders received by an agent in a foreign country; (3) they may be shipped by the manufacturer to a foreign purchaser to fill orders received by the manufacturer in the United States; (4) they may be shipped by the manufacturer to a foreign purchaser to fill orders solicited by mail and received by mail from the foreign purchaser. Articles may also be exported in certain other ways which will exempt the sale thereof from taxation.

**4777** Examples of sales by a manufacturer which are not made direct to a purchaser in a foreign country, but which are nevertheless not subject to tax, are: (1) A sale to a dealer in the United States, effected by compliance with the terms of the contract and shipping instructions to export; (2) a sale to an export commission house in the United States purchasing on behalf of a foreign buyer, which is effected by a shipment, either direct to the foreign buyer or consigned to the commission house at a domestic port and which is followed by immediate exportation by the commission house to the foreign buyer in whose behalf the purchase was made; (3) a sale to a dealer located in the United States under a contract which prohibits a disposition of the article in the United States; (4) a sale to an agent for a foreign purchaser who conducts a buying business in the United States for his principal and exports all articles bought.

**4778** No sale is exempt from taxation under the above-named Section of the Constitution, regardless of the circumstances under which made, unless the article sold is actually exported.

**4779** The application of the tax in respect of positive moving-picture films leased by the manufacturer, producer, or importer is governed by the same rules.

**4780** The taxes apply to articles sold in foreign commerce by a manufacturer located in a territory elsewhere in the United States than a State, and to articles going from the United States to any of its island or other possessions, including the Canal Zone, except that under acts of Congress articles going from the United States into the West Indian Islands acquired from Denmark, or into the Philippine Island or Porto Rico, are exempt from the taxes to the same extent as articles exported from a State to a foreign country.

**4781** This decision is supplemental to Regulations No. 44, approved May 31, 1918, and supersedes T. D. 2739, and T. D. 2781. (T. D. 3495, signed by Commissioner D. H. Blair, and dated July 10, 1923.)

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## EXCISE TAXES REGULATIONS

(Decision.)

November 7, 1923.

1917 and 1918 Acts.

**Fire apparatus held to be subject to tax as automobile trucks or wagons, and even though sold to a municipality.**

UNITED STATES DISTRICT COURT  
WESTERN DISTRICT OF NEW YORK

American-La France Fire Engine Company, Inc.

vs.

Vincent H. Riordan, Collector.

**4782** HAZEL, District Judge: [In part.] \* \* \*  
**4581** Plaintiff's point that its vehicles or machines were not primarily  
**4588** intended for transporting persons or property or things, and hence  
 are not included in the classification of Sec. 900 or any of the defini-  
 tions of the words "automobile" and "automobile truck" is not in my opinion  
 sustained since firemen and drivers and loads of course were intended to be  
 carried to and from fires. To argue that their transportation was merely  
 incidental to the operation of the machines or the extinguishing of fires is  
 beside the point if the view taken is correct that Congress used broad and  
 comprehensive terms in which plaintiff's productions are fairly included.

**4783** The next contention arises from the sales of fire trucks and apparatus  
 to municipalities. It is perfectly true that the Federal government  
 can not burden the State or subdivision thereof to which automobile trucks,  
 etc., were sold by plaintiff by imposing taxes upon them although there is no  
 express provision of the Constitution prohibiting it. The well established  
 exception of States and their subdivisions from tax by the Federal government  
 is implied from our dual system of government and the principle that the  
 National and State governments must function separately and separately  
 maintain instrumentalities for conducting their governmental operations,  
 and accordingly the states and municipalities can not be hampered or impaired  
 in administering their own affairs by the taxing power of the National  
 Congress. The tax in the present instance, however, was not a direct tax on  
 the municipalities to which articles were sold, nor on the articles acquired.  
 The tax imposed on plaintiff was for the privilege of vending and dealing  
 in the manufactured articles. (Sec. 602.) There was no connection as  
 agent or otherwise between plaintiff and the municipalities. It does not  
 relieve plaintiff that sales to municipalities were under contract. This  
 principle of taxation on sales finds support by analogy in various cases decided  
 by the Supreme Court of which U. S. v. Perkins, 163 U. S. 625; Snyder v.  
 Bettman, 190 U. S. 249, and South Carolina v. U. S. 199 U. S. 433, are  
 believed fair examples. The first two cases related to taxation of bequests  
 to the United States and to States and municipalities. The court held that  
 the taxes imposed were upon the right to acquire property by succession or  
 will and not upon the property of the State or municipality. In the South  
 Carolina case certain persons, as agents of the State, were selling intoxicating  
 liquor, and the court held that the salesmen were not relieved from paying

## EXCISE TAXES REGULATIONS

the internal revenue tax even though they had no interest in the profits since the tax was not upon the property of the State but upon the means by which that property was acquired. By a parity of reasoning the municipalities which bought fire vehicles are not in fact required to pay the tax, and hence the liability therefor is upon the manufacturer or salesman.

**4784** It is next urged that the earlier ruling by the Commissioner that the excise tax did not apply shows a persuasive uncertainty as to the inclusion of plaintiff's structures. In answer to this contention it must suffice to say that the erroneous interpretation of the statute by the Commission did not preclude the United States or the defendant from the right to impose and collect the tax on subsequent modification of the earlier rule. Nor has the later interpretation created equities which in fairness require the judicial adoption of the first interpretation. The tax is prescribed by statute, and, under Sec. 601 of the Revenue Act of 1917, no assessment was required, but monthly returns were necessary under oath by each manufacturer or producer, and payment of the tax apparently became self-executing. *Dollar Savings Bank v. U. S.*, 19 Wall. 227; *Christi-St. Com. Co. v. U. S.* 129 Fed. 506. It is true that a construction by an Executive Department upon an Act of Congress ought not to be lightly overturned either by the Department itself or by the court. *Edwards v. Wabash Ry. Co.* 264 Fed. 610, and it should not be done without cogent and persuasive reasons.

**4785** In the present case careful consideration has been given to the various questions involved, but in view of the conditions prevailing at the time the statute was passed, the emergency of war, and what seems to me to have been the evident intention of Congress to impose an excise tax on all kinds of automobiles and automobile trucks and wagons in which, without express exception, plaintiff's productions are included, I am constrained to the view that the ruling in favor of imposing the tax was correct and the original rulings were erroneous. The exception of tractors in the enactment adds force to the view that the intention of Congress is clearly expressed in the general language employed in both Acts. A case of long continued executive construction and payment of tax thereunder and adoption by Congress in consequence thereof is not presented, and hence the adjudications cited by plaintiff on that point are not controlling.

**4786** My conclusion is that the excise taxes paid by the plaintiff under sections 600 and 900 of the Revenue Acts were legally exacted. A decree may be entered dismissing the bill with costs.



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## WAR TAX SERVICE

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# TAX ON TELEGRAPH AND TELEPHONE MESSAGES.

BEING TITLE V OF THE REVENUE ACT OF 1921.

## CALENDAR.

**Returns:** On or before the last day of the month following that for which the return is made.

**Tax:** Amount of tax due to accompany return.

### TITLE V.—TAX ON TELEGRAPH AND TELEPHONE MESSAGES.

**5500** Sec. 500. That from and after January 1, 1922, there shall be levied, assessed, collected, and paid, in lieu of the taxes imposed by section 500 of the Revenue Act of 1918—

**5501** (a) In the case of each telegraph, telephone, cable, or radio, dispatch, message, or conversation, which originates on or after such date within the United States, and for the transmission of which the charge is more than 14 cents and not more than 50 cents, a tax of 5 cents; and if the charge is more than 50 cents, a tax of 10 cents; *Provided*, That only one payment of such tax shall be required, notwithstanding the lines or stations of one or more persons are used for the transmission of such dispatch, message, or conversation; and

#### [Tax on Leased Wire and Talking Circuit Special Service.]

**5502** (b) A tax equivalent to 10 per centum of the amount paid after such date to any telegraph or telephone company for any leased wire or talking circuit special service furnished after such date. This subdivision shall not apply to the amount paid for so much of such service as is utilized (1) in the collection and dissemination of news through the public press, or (2) in the conduct, by a common carrier or telegraph or telephone company, of its business as such;

#### [The United States and the States are Exempt.]

**5503** (c) No tax shall be imposed under this section upon any payment received for services rendered to the United States or to any State or Territory or the District of Columbia. The right to exemption under this subdivision shall be evidenced in such manner as the Commissioner, with the approval of the Secretary, may by regulation prescribe.

#### [Refund on partially used passage, seat, berth, and stateroom tickets, and mileage books.]

**5504** (d) Under regulations prescribed by the Commissioner with the approval of the Secretary, refund shall be made of the proportionate part of the tax collected under subdivision (c) or (d) of section 500 of the Revenue Act of 1918 on tickets or mileage books purchased and only partially used before January 1, 1922.

**TELEGRAPH AND TELEPHONE TAXES LAW.**

---

**[Tax paid by person paying for the Service.]**

**5505** Sec. 501. That the taxes imposed by section 500 shall be paid by the person paying for the services or facilities rendered.

**[Returns and Payment to the Government of Collected Taxes.]**

**5506** Sec. 502. (a) That each person receiving any payments referred to in section 500 shall collect the amount of the tax, if any, imposed by such section from the person making such payments, and shall make monthly returns under oath, in duplicate, and pay the taxes so collected to the collector of the district in which the principal office or place of business is located.

**5507** (b) Any person making a refund of any payment upon which tax is collected under this section may repay therewith the amount of the tax collected on such payment; and the amount so repaid may be credited against amounts included in any subsequent monthly return.

**5508** (c) The returns required under this section shall contain such information, and be made at such times and in such manner, as the Commissioner, with the approval of the Secretary, may by regulation prescribe.

**5509** (d) The tax shall, without assessment by the Commissioner or notice from the collector, be due and payable to the collector at the time so fixed for filing the return. If the tax is not paid when due, there shall be added as part of the tax a penalty of 5 per centum, together with interest at the rate of 1 per centum for each full month, from the time when the tax became due.

**[General Administrative Provisions of Law.]**

[Read under "Miscellaneous" at back of the book.]



## TELEGRAPH AND TELEPHONE REGULATIONS.

U. S. INTERNAL REVENUE  
Form 727—Revised Sept., 1922

## TAX ON TELEGRAPH AND TELEPHONE MESSAGES—(Title V, Section 500, Revenue Act of 1921)

CHARACTER OF TAX	RATE OF TAX	AMOUNT OF TAX
(a) Telegraph, telephone, and radio messages	5c and 10c	\$.....
(b) Leased wire (telephone or telegraph)	10 per cent	\$.....
<p>I swear (or affirm) that the foregoing is a true return of the amount of tax collected on the above-mentioned services for the month of ..... 192...., and that the amount deducted for overpayment is allowable by law.</p> <p>Signed .....</p> <p>(State whether individual owner of business, member of firm, or if officer of corporation, or duly authorized manager or agent, give title.)</p>		
Total tax collected		\$.....
Less overpayment for month of ..... 192....		\$.....
Total amount of tax due		\$.....
Penalty 25%		\$.....
Penalty 5%		\$.....
Interest		\$.....
Total amount due		\$.....

Sworn to and subscribed before me this ..... day of ..... 192....

(Name) or (Witness) (See paragraph 2 on back)

(Title) or (Witness)

Return with remittance should be sent to the Collector of Internal Revenue for your district and not to the Commissioner of Internal Revenue at Washington, D. C. (See Instructions, par. 2, on reverse of this form.) If you have nothing to report, make notation to that effect on this form and return to the Collector of Internal Revenue.

2-11328

ORIGINAL RETURN—This form must be returned to the Collector of Internal Revenue

[Obverse of Form 727]

## INSTRUCTIONS.

(For full instructions, see Regulations No. 57, Revised.)

Section 500 of the Revenue Act of 1921 imposes the following taxes upon telegraph and telephone messages:

(a) In the case of each telegraph, telephone, cable, or radio, dispatch, message, or conversation, which originates within the United States, and for the transmission of which the charge is more than 14 cents and not more than 50 cents, a tax of 5 cents; and if the charge is more than 50 cents, a tax of 10 cents:

(b) A tax of 10 per centum of the amount paid to any telegraph or telephone company for any leased-wire or talking-circuit special service furnished. This subdivision shall not apply to the amount paid for so much of such service as is utilized (1) in the collection and dissemination of news through the public press, or (2) in the conduct, by a common carrier or telegraph or telephone company, of its business as such.

1. **COMPUTATION OF TAX.**—The tax is imposed and must be computed and collected upon each separate service rendered and not upon the aggregate of charges made.

2. **RETURNS AND PAYMENT OF TAX.**—Return with remittance covering taxes collected in any month must be in the hands of the Collector of Internal Revenue (or his authorized representative) of the district in which the principal office or place of business of the person making the return is located on or before the last day of the succeeding month. Returns must be signed and sworn to before an officer authorized to administer oaths, but if the tax is less than \$10 the return may be signed or acknowledged before two subscribing witnesses.

3. **CREDITS.**—In case of any overpayment of tax due to an error in calculation, credit may be taken therefor against taxes due upon any subsequent monthly return. Credit may also be taken as outlined in the regulations. A complete and detailed record of such overpayment must be kept by the person taking credit therefor. In case credit is taken on this return for an overpayment made on a previous return, full information must be attached showing the reasons therefor and designating the kind of tax, and the month for which the previous return was filed and the date of payment.

4. **RECORDS.**—Every person, corporation, partnership, or association required to make this return must keep such records as will clearly show all charges upon which tax is required to be collected, in order that returns may be easily verified by revenue officers.

5. **PENALTIES.**—Failure to file on time, 25 per cent of tax. Failure to pay on time, 5 per cent of tax and 1 per cent interest a month. Severe penalties for failure to file returns or for false or fraudulent returns.

2-11328

[Reverse of Form 727.]

UNITED STATES INTERNAL REVENUE  
Form 727—Revised Sept., 1922

## RECEIPT FOR PAYMENT OF TAX ON TELEGRAPH AND TELEPHONE MESSAGES

Month of ..... 192....

THIS RECEIPT NOT TO BE DETACHED BY TAXPAYER

NOT VALID UNLESS RECEIPTED BY CASHIER

TAXPAYER WILL ENTER AMOUNT PAID IN THE SPACE PROVIDED THEREFOR

NAME AND ADDRESS	DATE PAID	AMOUNT PAID
	(CASHIER'S SIGNATURE)	\$.....

2-11328a

[Form 727 tax receipt form.]

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WAR TAX 1103 SERVICE

## TELEGRAPH AND TELEPHONE REGULATIONS.

## REGULATIONS 57, REVISED.—1921 ACT.

[Promulgated February 15, 1922.]

[T. D. 3294.]

## RELATING TO THE

## TAX ON TELEGRAPH, TELEPHONE, RADIO, AND CABLE FACILITIES

## UNDER THE

## REVENUE ACT OF 1921.

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WAR TAX 1104 SERVICE



## TELEGRAPH AND TELEPHONE REGULATIONS.

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## PART I.

## TRANSMISSION OF DISPATCHES, MESSAGES, AND CONVERSATIONS

## IMPOSITION OF TAX.

**5510** Article 1. **Imposition of the tax.—Transmission.**—The tax is im-  
 5500 posed upon the transmission of a message or conversation, by tele-  
 5501 phone, telegraph, radio, or cable. Transmission includes services  
 rendered and facilities provided by the carrier necessary or inci-  
 dental to the actual movement of the message; for example, messenger  
 service utilized in the movement of a toll message.

**5511** Transmission begins when the message is delivered by the sender  
 to the carrier or its agent, and continues until its receipt by the  
 addressee or his agent. Where, therefore, a message passes by the combined  
 facilities of several lines, there is one message and one transmission. But  
 where a sender uses a telephone toll message to reach a telegraph office to  
 secure the transmission of a telegraph message, the place of delivery of the  
 telegraph message by the sender to the carrier is the telegraph office, and  
 the transmission of the telegraph message begins there. The telephone  
 message is a separate message and as such subject to the provisions of the act.

**5512** Art. 2. **Imposition of tax—Carrier.**—The tax applies to transmis-  
 sion services when rendered for hire, whether or not the agency  
 rendering them is a common carrier. Accordingly, a carrier of dispatches,  
 messages, or conversations by telegraph, telephone, cable, or radio is held

## TELEGRAPH AND TELEPHONE REGULATIONS.

to be any person, corporation, partnership, or association who or which, for hire, furnishes the services or facilities described or referred to in section 500, subdivisions (a) and (b) of the act.

**5513** Therefore, where the lessee of a leased wire or talking circuit special service transmits messages for hire, he is a carrier of such messages and liable to the provisions of the act relative to the collection, report, and payment of the taxes thereon.

## ORIGIN OF MESSAGE DETERMINES TAXABILITY.

**5514** Art. 3. Originating with the United States.—The tax is upon the transmission by telephone, telegraph, radio, or cable of dispatches, messages, and conversations *originating within the United States*.

**5515** Messages transmitted from a point within the United States to a point without the United States are subject to the provisions of the act unless sent with charges "reversed" or "collect." Messages transmitted from a point without the United States to a point within the United States are not subject to the tax, unless sent with charges "reversed" or "collect."

**5516** The term "United States" includes the States, the Territories of Alaska and Hawaii, and the District of Columbia; it also includes all inland waters (such as rivers, lakes, bays, etc.) lying wholly within the United States, and, where an international boundary line divides inland waters, the parts of such inland waters as lie within the boundary of the United States; and also the waters known as a marine league from low tide on the coast line. Radio messages sent from ships within the above limits are therefore subject to the provisions of the act.

**5517** Art. 4. Reversed or collect messages.—The point of origin of messages transmitted with charges "reversed" or "collect" is the point at which the charge is collectible; that is, the point of receipt of the message by the addressee.

**5518** Art. 5. Effective date of the law.—The tax imposed under subdivisions (a) and (b) of section 500 of the Revenue Act of 1921 is in lieu of the tax imposed under subdivisions (f) and (g) of section 500 of the Revenue Act of 1918 and is upon the transmission by telephone, telegraph, radio or cable, of dispatches, messages, and conversations originating on or after January 1, 1922. The rate of taxation is the same under both acts. The provisions of the Revenue Act of 1918 are effective as to all taxable services or facilities furnished between midnight of March 31, 1919, and midnight of December 31, 1921; the provisions of the Revenue Act of 1921 do not apply to services or facilities furnished prior to midnight of December 31, 1921, but do apply to such services or facilities furnished subsequent to midnight of December 31, 1921. The time of the payment of the charge is immaterial.

## BASIS, RATE, AND COMPUTATION OF TAX.

**5519** Art. 6. Basis, rate, and computation of tax.—The basis for the computation of the tax is the *amount of the charge* for the transmission of the message. (As to the meaning of transmission, see art. 1.) The term "the charge" means the amount charged by the carrier for the transmission of the particular message. Such charge may be due in money, services, or in any other valuable consideration.

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WAR TAX 1106 SERVICE



## TELEGRAPH AND TELEPHONE REGULATIONS.

**5520** Only two amounts of tax are provided, 5 cents and 10 cents, imposed as follows:

**5521** (1) 5 cents on messages the charge for the transmission of which is more than 14 cents and not more than 50 cents.

**5522** (2) 10 cents on messages the charge for the transmission of which is more than 50 cents.

**5523** **Art. 7. Franks.**—If the message is in fact transmitted free, no tax applies; but if the carrier in fact makes a charge, in money, services, or any other consideration, for the transmission of the message, the tax applies and is to be computed upon the amount of the charge imposed.

**5524** **Art. 8. Overtime telephone messages.**—The tax on overtime telephone messages is to be computed upon the total charge for the transmission of the message. The amount of the initial rate for such messages is immaterial.

**5525** **Art. 9. Messages transmitted under contract.**—Where, by contract, a telegraph, telephone, radio, or cable company agrees, in consideration of the payment of a lump sum or of the performance of services, to transmit messages on frank, such messages are subject to the tax imposed by this section (500 (a)) of the act. The tax on each such message is to be computed upon the amount of the regular established charge for the transmission of similar messages for ordinary customers, calculated at the regular fixed rate provided in the tariffs of the transmitting carrier. The questions as to whether such messages relate to the operation of the business of a common carrier and whether they are "on line" or "off line" are immaterial. Thus, a telegraph company agrees to transmit over its lines on a railroad line all messages relating to railroad business "free" and all such messages over its lines off the railroad lines "free" to an amount not exceeding \$10,000 per year calculated at its regular rates, and all messages over that amount at half rates, in consideration of services to be performed by the railroad in the transportation of men and materials of the telegraph company. All such messages, whether "on line" or "off line," and whether "free" or at half rates, are subject to the tax provided by this section (500 (a)) of the act. The tax must be computed, collected, and paid upon each such message.

[For Court Decision sustaining similar provision to above in the Regulations under the 1918 Act see *W. U. Tel. Co. vs. D. L. & W. R. R.*, 282 Fed. 925.—1922 War Tax Service, p. 1117. T. D. 3369.]

## EXEMPTIONS.

**5526** **Art. 10. Exemptions—Business of transmitting carrier.**—The transmission of messages involved in the conduct of the business of the transmitting carrier, as such, is not subject to the tax.

**5527** **Art. 11. Exemption—Charges of 14 cents or less.**—Dispatches, messages, or conversations, for the transmission of which by telegraph, telephone, radio, or cable the charge is 14 cents or less, are not subject to tax. (As to the meaning of transmission, see Art. 1; as to the computation of the tax, see Arts. 6-9.)

**5528** **Art. 12. Exemption—Services rendered to the United States or to**  
**5503** **any State or Territory or to the District of Columbia.**—Telephone, telegraph, cable, and radio dispatches, messages, and conversations relating to Government business, which originate in the United States and

## TELEGRAPH AND TELEPHONE REGULATIONS.

which are a charge against the Treasurer of the United States, the District of Columbia, a State, or Territory, and are paid from the funds thereof, are exempt from the tax. Messages, conversations, and dispatches which are not paid from such funds are not exempt from tax, even though they relate to Government business.

**5529 Art. 13. Political subdivisions of State or Territory.**—The words "State" and "Territory" as used in section 500 (c) of the act and in article 12 (above) include political subdivisions thereof, such as counties, cities, towns, and other municipalities.

**5530 Art. 14. Government agencies.**—Services rendered to agencies of the United States are, subject to the conditions prescribed in article 12, exempt from tax. Such agencies include the American National Red Cross, United States Shipping Board, Emergency Fleet Corporation, Federal Farm Appraisers, Federal Land Banks, Federal Reserve Banks, Panama Railroad Co., and similar agencies supported by Government funds.

**5531 Art. 15. Evidence of right of exemption.**—Where a message is accepted and transmitted by a carrier as a Government message and entitled as such to exemption under section 500 from the tax on charges for transmission thereof, the right to such exemption shall be evidenced in one of the following ways:

**5532 (a)** Payment of such charge directly to the carrier by the Government to which the services are rendered.

**5533 (b)** A standard form of exemption certificate for use of the Federal Government, substantially in form following:

TREASURY DEPARTMENT  
FORM

## EXEMPTION CERTIFICATE.

TAX ON TRANSMISSIONS BY TELEGRAPH, TELEPHONE, RADIO AND CABLE.

..... (Date.)  
Sender..... Place of receipt.....  
Addressee..... Place of delivery.....  
Place of payment of charges.....  
Name of carrier collecting charges.....  
Other identification of message, conversation, or dispatch.....

I certify that the transmission charges on the message or messages to which this exemption certificate is attached have been or will be paid by the United States, and such charges thereon amounting to \$..... are exempt under section 500 of the revenue act of 1921 from the tax imposed by said act.

..... (Signature of Government officer or employee.)

..... (Federal department or establishment.)

..... (Title.)

Penalty for fraudulent use, \$1,000 and imprisonment.

**NOTE.**—Agents of telegraph, telephone, radio, and cable companies should not accept this certificate unless satisfied, through the production of proper credentials or otherwise, that the person who signed it is an officer or employee of the Federal Government.

A separate exemption certificate will be required for each message when paid for as a separate item, but where periodical payments are made for services rendered to Government officers or departments, a blanket certificate may be accepted as evidence of right to exemption.

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WAR TAX -1108 SERVICE



## TELEGRAPH AND TELEPHONE REGULATIONS.

**5534** A form of exemption certificate substantially in accord with the above form should be provided by the States, the Territories of Alaska and Hawaii, and the District of Columbia, or the political subdivisions thereof, for the use of officials and employees.

**5535** Art. 16. Exemptions—Foreign diplomats.—(a) Ambassadors, ministers, and other properly accredited diplomatic representatives of foreign Governments to the United States are exempt from the payment of taxes upon the transmission of messages sent by or for them.

**5536** (b) The exemption does not apply to consuls or to any officials of foreign Governments other than those specified in paragraph (a).

**5537** (c) The exemption does not apply to messages the charge for the transmission of which is paid by a foreign Government, except in the cases provided for in paragraph (a).

**5538** Art. 17. Evidence of right to exemption.—The following form may be used to secure exemption when signed by an ambassador, minister, or any other properly accredited diplomatic representative of a foreign Government:

....., 19.....  
(Date.)

I certify that this message from ..... to .....  
over..... is transmitted by ..... attached to  
my..... and is exempt from tax.

.....  
(Title.)

.....  
(Address.)

## PART II.

## LEASED WIRE AND TALKING CIRCUIT SPECIAL SERVICE.

## IMPOSITION OF TAX.

**5539** Art. 18. Imposition of the tax—Leased wire or talking circuit  
5502 special service.—The tax is imposed upon the amount paid for any  
leased wire or talking circuit special service.

**5540** Leased wire special service.—Leased wire special service includes exclusive leases of wires and also contracts by which the carrier agrees to furnish a circuit (that is, a wire or wires, instruments and electrical energy) for the transmission of messages in Morse characters or by spoken word between specified points or offices during specified hours. Operators may or may not be employees of the carrier.

**5541** For administrative purposes it is held that where the area covered by leased wire special service is served by a local telephone exchange, tolls not being charged upon messages transmitted between points within such area, such special service does not come within the provisions of the act.

## TELEGRAPH AND TELEPHONE REGULATIONS.

**5542 Talking circuit special service.**—Talking circuit special service is a limited class of leased wire special service and refers to such service where the transmission is telephonic.

**5543** Such a talking circuit may by contract have one terminal at a switchboard of the carrier, allowing connection with any telephone within the local exchange area of the operating station. Such additional exchange and other incidental service is included in the term "talking circuit special service."

**5544 Art. 19. Private branch exchange service.**—Amounts paid for private branch exchange service (called P. B. X. service) where the exchange equipment is located on the premises of the lessee and is used for intercommunication between departments of the business or parts of the premises of the lessee, are not subject to tax. Any amount paid for special service at the central exchange in the handling of calls from such a private branch exchange is included in the term "private branch exchange service."

**5545 Art. 20. Tie lines.**—The term "tie line" is used to denote a line connecting two private branch exchanges. The amount paid for rental of a tie line connecting two or more private branch exchanges located within an area served by a local telephone exchange without charging tolls, is to be considered part of the amount paid for private branch exchange service and is not subject to tax. But a tie line connecting two or more private branch exchanges not within the same local telephone exchange area, tolls being ordinarily imposed upon the transmission of messages between the points of location of the private branch exchanges, is a leased wire and the amount paid for the rental thereof is subject to the provisions of this section of the act.

**5546 Art. 21. Private lines and extension lines** are subject to the same distinction and same rules as tie lines.

**5547 Art. 22. Intercommunication and interior systems** are subject to the same provisions as private branch exchanges.

**5548 Art. 23. Long-distance terminals.**—Amounts paid for a long-distance terminal, consisting of a special terminal loop from a local toll position or a long line switchboard to the subscriber's premises, and used only for long-distance calls at the regular toll, are not subject to the tax imposed by this section of the act. Messages transmitted over such wires are subject to the "message tax" provided for in section 500 (a).

## BASIS, RATE, AND COMPUTATION OF TAX.

**5549 Art. 24. Basis, rate, and computation of the tax.**—The tax imposed is to be computed at 10 per cent of the amount paid for the services specified.

**5550** The amount paid includes the contract consideration and all additional charges therein provided, including salaries of operators if in the employ of the carrier, charges for equipment, instruments, and other apparatus, drops intermediate to the terminals, branch or "leg" lines, exchange service, and overtime service. It also includes charges for incidental additional service, including charges for "service connection," "termination,"



## TELEGRAPH AND TELEPHONE REGULATIONS.

and "moves" when such are involved in the special service contracted for; such charges not involved in such special service are not subject to the tax.

**5551** In the payment of any tax under this section a fractional part of a cent shall be disregarded unless it amounts to one-half cent or more, in which case it shall be increased to one cent. (Sec. 1306 [18019] of the act.)

**5552 Art. 25. Computation of tax—Effective date.**—The tax provided in section 500 (b) applies where (a) the amount paid for such service is paid after January 1, 1922, and (b) the service is furnished after January 1, 1922. Therefore, where leased-wire special service was furnished on or after January 1, 1922, but the consideration therefor had been paid prior to that date, the tax imposed by section 500 (b) of the Revenue Act of 1921 does not apply, but the tax imposed by section 500 (g) of the Revenue Act of 1918 would apply if such consideration were paid subsequent to April 1, 1919. Where such service was furnished prior to or on April 1, 1919, the tax imposed by section 500 (g) of the Revenue Act of 1918 or by section 500 (b) of the Revenue Act of 1921 does not apply, regardless of the date of the payment of the charges therefor.

**5553 Art. 26. Computation of tax—Service performed between a point within and a point without the United States.**—When leased wire or talking circuit special service is furnished between a point or points within the United States and a point or points without the United States and there is in the contract no reasonable established division of charges as domestic and foreign, the tax shall be paid and collected upon the amounts paid for incidental services or facilities furnished within the United States plus that proportion of the general contract consideration as the wire mileage within the United States bears to the total wire mileage contracted for. Where there is a reasonable division of charges as domestic and foreign provided in the contract, the tax shall be paid and collected upon the amounts specified as payments for services or facilities rendered within the United States.

## EXEMPTIONS.

**5554 Art. 27. Exemptions—Services to United States, the States, the District of Columbia, and to Foreign Diplomats.**—The exemptions of services rendered the United States, a State or Territory and the District of Columbia, and foreign diplomats described in Articles 12 to 17 above, apply also to this section of the act.

**5555 Art. 28. Exemptions—Public press.**—The tax does not apply to the amount paid for so much of such special service as is utilized in the collection and dissemination of news through the public press. "Public press" is not restricted to newspapers or to any particular portion of the product of printing presses. Magazines, periodicals, trade and scientific publications, published for the information of the public, are included. Organizations such as the Associated Press and the United Press are also included.

**5556** "News" is a word to be liberally construed. Accounts of current events, public announcements, information relating to finance, science, commerce, religion, civic, or other public organizations are held to be news.

## TELEGRAPH AND TELEPHONE REGULATIONS.

**5557** The exemption does not apply to the publisher or to the publication as such. The exemption applies only to the amount paid for *so much of such service as is utilized in the collection and dissemination of news* in the public press. If, however, a contract between a person or company engaged in the collection and dissemination of news through the public press and a carrier provides for leased wire or talking circuit special service to be utilized exclusively in the business mentioned, the carrier is not required to collect the tax upon the amounts paid under such contract in the absence of actual knowledge on the part of the carrier that the service is being used for other purposes. The exemption has no application to the transmission of messages.

**5558** **Art. 29.<sup>7</sup> Exemption—Services utilized in the conduct of business of common carrier or telegraph or telephone company.**—The tax does not apply to the amount paid for so much of such special service as is utilized in the conduct, by a common carrier or telegraph or telephone company, of its business as such.

**5559** A common carrier is one who undertakes, for hire or reward, to transport the goods or person of such as choose to employ him from place to place.

**5560** The exemption does not apply to common carriers, telegraph and telephone companies, as such. It applies only to the amount paid for *so much of such service (leased wire or talking circuit) as is utilized in the conduct* by a common carrier, telegraph or telephone company, *of its business as such.*

**5561** Where, however, a contract between a common carrier (or telegraph or telephone company) and a telegraph, telephone, radio, or cable company provides for leased wire or talking circuit special service *to be utilized exclusively in the conduct of the business of the common carrier (or telegraph or telephone company) as such*, the telegraph, telephone, cable, or radio company is not required to collect the tax upon the amounts paid under such contract in the absence of actual knowledge on the part of the company that the service is being used for other purposes.

**5562** The exemption does not apply to contracts which provide merely for the transmission of messages. Thus, where a telegraph or telephone company agrees by contract with a railroad to transmit, on frank or otherwise, the messages of such railroad, its officials, or employees, in a certain manner or upon certain terms, such a contract is a contract providing for the transmission of messages, and each such message is subject to the "message" tax. (See Art. 9 above.) No exemption exists by reason of such contract. The exemption applies only to *leased wire or talking circuit special service* utilized by a common carrier in the conduct of its business as such. Thus where a telegraph or telephone company agrees by contract to set apart a certain wire or wires for the use of a railroad in the conduct of its business as such, the amounts paid for such service are not subject to tax. A proviso in such a contract to the effect that when such wire or wires are not being used by the railroad they may be used by telegraph or telephone company for the transmission of commercial messages will not change the character of the contract.



## TELEGRAPH AND TELEPHONE REGULATIONS.

## PART III.

## PAYMENT, COLLECTION, RETURN, AND REMITTANCE OF TAXES.

**5563 Art. 30. Payment of taxes.**—Taxes imposed by section 500 (a) and 5505 (b) shall be paid by the person from whom the carrier collects the 5506 charges for the services or facilities rendered.

**5564 Art. 31. Collection of taxes.**—All such taxes shall be paid to and collected by the officers, agents, or other employees of the carrier to which the charges for the services or facilities are due.

**5565 Art. 32. Credit.**—Where credit is extended by a carrier to a sender or addressee for the payment of charges for the transmission of a message, or to the lessee of special service for the payment of charges for such service, and such charges are not paid, the tax nevertheless applies and the carrier is liable for the collection thereof.

**5566 Art. 33. Records.**—Records and accounts of telegraph, telephone, radio, and cable companies showing records of (1) all dispatches, messages, or conversations originating on the lines of such company, the charge for the transmission of which is over 14 cents, whether taxable or not, (2) leased wire and talking circuit special services rendered by the company, and (3) evidences of the right of exemption of dispatches, messages, conversations, and special service upon which tax is not collected, such records to contain sufficient information to determine the taxability of the message or service and the amount of tax, if any, upon same, shall at all times be open to the inspection of officers of the Treasury Department.

**5567 Art. 34. Returns—Contents.**—The returns of a telephone, telegraph, radio, or cable company shall be rendered on Form 727 (Revised) [page 1103] and shall include (a) all taxable dispatches, messages, or conversations originated by it or on its lines and (b) such leased wire or talking circuit special services, as are recorded and accounted for by the reporting company and reflected in its billing records for the month, following its usual business routine.

**5568** Taxable messages which originate at the stations of rural or farmers' line associations and which are recorded and billed by the telephone company operating the exchange to which such stations are connected for service should be included in the return of said operating company. Taxable messages, if they originate at the station of such rural or farmers' line associations and are not recorded or billed by the operating company, should be reported by such association.

**3569 Art. 35. Returns—When and where rendered.**—Returns must be made for each calendar month. Such returns must be made under oath, in duplicate, and must be filed with the collector of the district in which the principal office or place of business of the company is located on or before the last day of the calendar month following the month for which return is made. Where a return covers a tax of \$10 or less it may be signed and acknowledged before two witnesses, instead of under oath.

## TELEGRAPH AND TELEPHONE REGULATIONS.

**5570 Art. 36. Extension of time.**—Where it is found impossible to make the proper return within the prescribed time, request may be filed with the collector for an extension of time, and upon a proper showing the collector is authorized to fix a definite time in each instance within which the return may be filed, such extension of time not to exceed 60 days.

**5571 Art. 37. Remittance of taxes collected.**—The tax is due and payable by the person collecting the tax to the collector of internal revenue at the time fixed for filing the return.

## CREDITS AND REFUNDS.

Law ¶8018, ¶8023.

**5572 Art. 38. Credit for overpayment.**—Any individual, corporation, partnership, or association that has paid to the collector of internal revenue, as a tax under section 500 of the act, any amount erroneously or illegally assessed or collected or any amount in excess of the amount of the tax actually imposed by that section for the month covered by that payment, may claim credit for such overpayment against the amount of the tax imposed by that section which is due upon any other monthly return thereafter made in the same behalf on Form 727 (Revised). Such credit will only be granted, however, if, in making the claim, the instructions printed on the back of that form are carefully followed.

**5573 Art. 39. Refund of overpayment.**—Any individual, corporation, partnership, or association that has paid to the collector of internal revenue, as a tax under section 500 of the act, any amount erroneously or illegally assessed, or any amount in excess of the amount of the tax actually imposed by that section for the month covered by that payment, or any amount as a penalty for the collection of which there was no authority, may secure a refund of the amount so overpaid by filing with the collector to whom such payment was made a properly prepared claim on Form 46 (revised) [Form 843].

**5574 Art. 40. Refund of overcollection.**—Every individual, corporation, partnership, or association that has collected from any person, as a tax under section 500 of the act, any amount in excess of the amount of the tax imposed by that section actually due from such person, shall upon proper application promptly refund such amount to the person entitled thereto, even though such amount has already been paid over to the collector of internal revenue and no corresponding credit (see art. 38) or refund (see art. 39) has yet been secured. Any person making a refund of any payment upon which tax is collected under this section may repay therewith the amount of the tax collected on such payment.

## PENALTIES.

**5575 Art. 41. Penalties.**—(1) Section 502 (d) of the act specifically provides that the taxes under section 500 shall (without assessment by the Commissioner or notice from the collector) be due at the time fixed for filing this return, and if the tax is not paid at such time there shall be added as part of the tax a penalty of 5 per cent, together with interest at the rate of 1 per cent for each full month from the time when the tax becomes due.



## TELEGRAPH AND TELEPHONE REGULATIONS.

**5576** (2) [See Sec. 1302, ¶8014.]

**5577** (3) Section 3176 of the Revised Statutes [¶8073], as amended and reenacted, provides that in case of any failure to make and file a return within the prescribed time there shall be added to the tax 25 per cent of its amount.

**5578** (4) Section 3176 of the Revised Statutes [¶8073], as amended and reenacted, further provides that in case a false or fraudulent return is willfully made there shall be added to the tax 50 per cent of its amount.

## AUTHORITY FOR REGULATIONS.

**5579** Art. 42. Promulgation of regulations.—In pursuance of this provision of the act [¶8009] the foregoing regulations are hereby made and promulgated and all rulings inconsistent with them are hereby revoked.

D. H. BLAIR,

*Commissioner of Internal Revenue.*

Approved February 15, 1922 [Released for publication February 28, 1922.]

A. W. MELLON,

*Secretary of the Treasury.*

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(T. D. 3485.)

**5580** Time for filing returns and payment of taxes.—The sixth sentence of 5569 Article 41, Regulations 43, (Part 1); the fifth sentence of Article 13, Regulations 43, (Part 2); the fourth sentence of Article 36, Regulations 47; the sixth sentence of Article 32, Regulations 48; the first sentence of Article 20, Regulations 52; and the second sentence of Article 35, Regulations 57, are hereby amended by inserting a comma at the end thereof, and adding the following: "except that when the last day of the month in which a return and payment are due falls on Sunday or a legal holiday, the return may be filed and payment made to the Collector of Internal Revenue or Deputy Collector on the next secular or business day." (T. D. 3485, signed by D. H. Blair, Commissioner, and dated June 1, 1923.)





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# TAX ON ADMISSIONS AND DUES.

BEING TITLE VIII OF THE REVENUE ACT OF 1921.

## CALENDAR.

**Returns:** On or before the last day of the month following that for which the return is made.

**Tax:** Amount of tax due to accompany return.

## TITLE VIII.—ADMISSIONS.

**6500** **Sec. 800.** (a) That from and after January 1, 1922, there shall be levied, assessed, collected, and paid, in lieu of the taxes imposed by section 800 of the Revenue Act of 1918—

### [Regular Admission in Excess of 10 cents Being Charged.]

**6501** (1) A tax of 1 cent for each 10 cents or fraction thereof of the amount paid for admission to any place on or after such date, including admission by season ticket or subscription, to be paid by the person paying for such admission; but where the amount paid for admission is 10 cents or less, no tax shall be imposed;

### [Tickets Sold by Ticket Agencies.]

**6502** (2) Upon tickets or cards of admission to theaters, operas, and other places of amusement, sold at news stands, hotels, and places other than the ticket offices of such theaters, operas, or other places of amusement, at not to exceed 50 cents in excess of the sum of the established price therefor at such ticket offices plus the amount of any tax imposed under paragraph (1), a tax equivalent to 5 per centum of the amount of such excess; and if sold for more than 50 cents in excess of the sum of such established price plus the amount of any tax imposed under paragraph (1), a tax equivalent to 50 per centum of the whole amount of such excess, such taxes to be returned and paid, in the manner and subject to the penalties and interest provided in section 903, by the person selling such tickets;

### [Tickets Sold by Theaters in Excess of Established Price.]

**6503** (3) A tax equivalent to 50 per centum of the amount for which the proprietors, managers, or employees of any opera house, theater, or other place of amusement sell or dispose of tickets or cards of admission in excess of the regular or established price or charge therefor, such tax to be returned and paid, in the manner and subject to the penalties and interest provided in section 903 [§4519 herein], by the person selling such tickets;

### [Boxes or Seats Owned or Leased.]

**6504** (4) In the case of persons having the permanent use of boxes or seats in an opera house or any place of amusement or a lease for the use of such box or seat in such opera house or place of amusement (in lieu of the tax imposed by paragraph (1)), a tax equivalent to 10 per centum of the amount for which a similar box or seat is sold for each performance or exhibi-

tion at which the box or seat is used or reserved by or for the lessee or holder, such tax to be paid by the lessee or holder; and

**[Cabarets and Other Similar Entertainments.]**

**6505** (5) A tax of  $1\frac{1}{2}$  cents for each 10 cents or fraction thereof of the amount paid for admission to any public performance for profit at any roof garden, cabaret, or other similar entertainment, to which the charge for admission is wholly or in part included in the price paid for refreshment, service, or merchandise; the amount paid for such admission to be deemed to be 20 per centum of the amount paid for refreshment, service, and merchandise; such tax to be paid by the person paying for such refreshment, service, or merchandise.

**[Specific Exemptions.]**

**6506** (b) No tax shall be levied under this title in respect to (1) any admissions all the proceeds of which inure (A) exclusively to the benefit of religious, educational, or charitable institutions, societies, or organizations, any post of the American Legion or the Women's Auxiliary units thereof, societies for the prevention of cruelty to children or animals, or societies or organizations conducted for the sole purpose of maintaining symphony orchestras and receiving substantial support from voluntary contributions, or of improving any city, town, village, or other municipality, or of maintaining a cooperative or community center moving-picture theater—if no part of the net earnings thereof inures to the benefit of any private stockholder or individual; or (B) exclusively to the benefit of persons in the military or naval forces of the United States; or (C) exclusively to the benefit of persons who have served in such forces and are in need; or (2) any admissions to agricultural fairs if no part of the net earnings thereof inures to the benefit of any stockholders or members of the association conducting the same, or admissions to any exhibit, entertainment, or other pay feature conducted by such association as part of any such fair,—if the proceeds therefrom are used exclusively for the improvement, maintenance and operation of such agricultural fairs.

**[The Term "Admission" Defined.]**

**6507** (c) The term "admission" as used in this title includes seats and tables, reserved or otherwise, and other similar accommodations, and the charges made therefor.

**[Price to be Printed on Each Ticket.]**

**6508** (d) The price (exclusive of the tax to be paid by the person paying for admission) at which every admission ticket or card is sold shall be conspicuously and indelibly printed, stamped, or written on the face or back of that part of the ticket which is to be taken up by the management of the theater, opera, or other place of amusement, together with the name of the vendor if sold other than at the ticket office of the theater, opera, or other place of amusement. Whoever sells an admission ticket or card on which the name of the vendor and price is not so printed, stamped, or written, or at a price in excess of the price so printed, stamped, or written thereon, is guilty of a misdemeanor, and upon conviction thereof shall be fined not more than \$100.



**TAX ON ADMISSIONS AND DUES LAW.****TITLE VIII.—DUES.**

**6509** **Sec. 801.** That from and after January 1, 1922, there shall be levied, assessed, collected, and paid, in lieu of the taxes imposed by section 801 of the Revenue Act of 1918, a tax equivalent to 10 per centum of any amount paid on or after such date, for any period after such date, (a) as dues or membership fees (where the dues or fees of an active resident annual member are in excess of \$10 per year) to any social, athletic, or sporting club or organization; or (b) as initiation fees to such a club or organization, if such fees amount to more than \$10, or if the dues or membership fees (not including initiation fees) of an active resident annual member are in excess of \$10 per year; such taxes to be paid by the person paying such dues or fees:

**6510** *Provided,* That there shall be exempted from the provisions of this section all amounts paid as dues or fees to a fraternal society, order, or association, operating under the lodge system.

**6511** In the case of life memberships a life member shall pay annually, at the time for the payment of dues by active resident annual members, a tax equivalent to the tax upon the amount paid by such a member, but shall pay no tax upon the amount paid for life membership.

**[Returns and Payment of Taxes.]**

**6512** **Sec. 802.** That every person receiving any payments for such admission, dues, or fees, shall collect the amount of the tax imposed by section 800 or 801 from the person making such payments. Every club or organization having life members, shall collect from such members the amount of the tax imposed by section 801. In all the above cases returns and payments of the amount so collected shall be made at the same time and in the same manner and subject to the same penalties and interest as provided in section 502 [¶5506 herein].

**[General Administrative Law Provisions.]**

[Read under "Miscellaneous Matters" at the back of the book.]

**TAX ON ADMISSIONS AND DUES REGULATIONS.**

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**I.**

**Regulations 43, Part I**

**Relating to**

**Admissions**

As amended to January 1, 1923.

[See page 1319. Fully indexed at the end of this division.]

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**II.**

**Regulations 43, Part II**

**Relating to**

**Dues**

As amended to January 1, 1923.

[See page 1307. Fully indexed at the end of this division.]

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[See yellow Admissions and Dues Supplementary Page 1 immediately before the blue Admissions Tax Index at the end of this division.]



## TAX ON ADMISSIONS AND DUES REGULATIONS.

UNITED STATES INTERNAL REVENUE  
Form 729—Revised Sept., 1922TAX ON ADMISSIONS AND DUES  
(Title VIII, Sections 800-802, Revenue Act of 1921)

Note: Ticket brokers are not to report tax on this form. Taxes due from such brokers must be reported on Form 729-A, Revised.

ADMISSIONS—CHARACTER OF TAX	AMOUNT OF TAX
(a) Admissions	\$.....
(b) Leases, etc., of boxes and seats	.....
(c) Roof gardens, cabarets, and similar entertainments	.....
(d) Excess over established prices—Box-office sales	.....

I swear (or affirm) that the foregoing is a true return of the amount of tax collected on admissions and dues for the month of ....., 192, and that the amount deducted for overpayment is allowable by law.

Signed .....

(State whether individual owner of business, member of firm, or if officer of corporation, club, or organization, or duly authorized manager or agent, give title.)

DUES—CHARACTER OF TAX	AMOUNT OF TAX
(e) Dues	\$.....
(f) Initiation fees	.....
(g) Life members	.....
Total tax collected	.....
Less overpayment for month of ....., 192	.....
Total amount of tax due	.....
Penalty 25%	.....
Penalty 5%	.....
Interest	.....
Total amount due	.....

Sworn to and subscribed before me this ..... day of ....., 192

(Name) or (Witness) (See paragraph 8 on back) (Title) or (Witness)

Return with remittance should be sent to the Collector of Internal Revenue for your district and not to the Commissioner of Internal Revenue at Washington, D. C. (See instructions, par. 6, on reverse of this form.) If you have nothing to report, make notation to that effect on this form and return to the Collector of Internal Revenue.

2-11540

ORIGINAL RETURN—This form must be returned to the Collector of Internal Revenue

UNITED STATES INTERNAL REVENUE  
Form 729—Revised Sept., 1922TAX ON ADMISSIONS AND DUES  
(Title VIII, Sections 800-802, Revenue Act of 1921)

Note: Ticket brokers are not to report tax on this form. Taxes due from such brokers must be reported on Form 729-A, Revised.

ADMISSIONS—CHARACTER OF TAX	AMOUNT OF TAX
(a) Admissions	\$.....
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(c) Roof gardens, cabarets, and similar entertainments	.....
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Signed .....

(State whether individual owner of business, member of firm, or if officer of corporation, club, or organization, or duly authorized manager or agent, give title.)

DUES—CHARACTER OF TAX	AMOUNT OF TAX
(e) Dues	\$.....
(f) Initiation fees	.....
(g) Life members	.....
Total tax collected	.....
Less overpayment for month of ....., 192	.....
Total amount of tax due	.....
Penalty 25%	.....
Penalty 5%	.....
Interest	.....
Total amount due	.....

Sworn to and subscribed before me this ..... day of ....., 192

(Name) or (Witness) (See paragraph 8 on back) (Title) or (Witness)

Return with remittance should be sent to the Collector of Internal Revenue for your district and not to the Commissioner of Internal Revenue at Washington, D. C. (See instructions, par. 6, on reverse of this form.) If you have nothing to report, make notation to that effect on this form and return to the Collector of Internal Revenue.

2-11540b

DUPLICATE RETURN—This form must be returned to the Collector of Internal Revenue

[Obverse of Form 729]

## TAX ON ADMISSIONS AND DUES REGULATIONS.

## INSTRUCTIONS.

(For full instructions, see Regulations No. 43, Parts I and 2, Revised.)

- Sections 800-802 of the Revenue Act of 1921 impose the following taxes upon admissions and dues:
- 1. ADMISSIONS.**—(a) *Regular admissions.* One cent for each 10 cents or fraction thereof of the amount paid for admission to any place. This tax shall not be imposed where the amount paid for admission is 10 cents or less.
  - (b) *Tickets sold at news stands, hotels, and places other than the ticket offices of theaters, operas, or other places of amusement,* at an advance of not more than 50 cents in excess of the established price, 5 per cent of such excess; when sold for more than 50 cents advance, 50 per cent of such excess, in addition to the tax imposed by (a) above. (SUCH TAX MUST BE REPORTED ON FORM 729-A, REVISED, COMPLETE INSTRUCTIONS ARE GIVEN ON FORM 729-A, REVISED, FOR REPORTING THIS TAX.)
  - (c) *Tickets sold by theaters* in excess of the established price, 50 per cent of such excess, in addition to tax imposed by (a) above.
  - (d) *Losses of boxes and seats.* In lieu of tax imposed by (a) above, a tax of 10 per cent of the amount for which a similar box or seat is sold for each performance at which box or seat is used or reserved.
  - (e) *Cabarets.* One and one-half cents for each 10 cents or fraction thereof of the admission price; admission price is deemed to be 20 per cent of the amount paid for service and merchandise.
  - 2. DUES.**—(a) Ten per cent of amount paid to any social, athletic, or sporting organization, where the dues of an active resident annual member are in excess of \$10.
  - (b) *Initiation fees.* Ten per cent of the amount paid to any social, athletic, or sporting organization, (1) if such fees exceed \$10, or (2) if dues of an active resident annual member exceed \$10.
  - (c) *Life members.* Tax equivalent to that of active resident annual member to be paid at the time of payment of dues by such resident members.
  - 3. EXEMPTIONS.**—(a) *Dues or fees* paid to fraternal societies operating under the lodge system.
  - (b) *Admissions,* all the proceeds of which inure (a) exclusively to the benefit of religious, educational, or charitable institutions, societies, or organizations, any post of the American Legion or the woman's auxiliary units thereof, societies for the prevention of cruelty to children or animals, or societies or organizations conducted for the sole purpose of maintaining symphony orchestras and receiving substantial support from voluntary contributions, or of improving any city, town, village, or other municipality, or of maintaining a cooperative or community center moving picture theater—if no part of the net earnings thereof inures to the benefit of any private stockholder or individual; or (b) exclusively to the benefit of persons in the military or naval forces of the United States; or (c) exclusively to the benefit of persons who have served in such forces and are in need; or (2) any admissions to agricultural fairs if no part of the net earnings thereof inures to the benefit of any stockholders or members of the association conducting the same, or admissions to any exhibit, entertainment, or other pay feature conducted by such association as part of any such fair, if the proceeds therefrom are used exclusively for the improvement, maintenance, and operation of such agricultural fairs. Claim, however, must be made for exemption on Form 759.

- 4. WHO MUST MAKE RETURN, COLLECT, AND PAY TAX.**—Any person or organization receiving payment for admissions or dues or being a club and having taxable life members must collect the tax from the person paying admission, dues or fees, except in 1 (b) and 1 (c) above, when vendor must pay tax on the excess charge.
- 5. COMPUTATION OF TAX.**—Tax on admissions is imposed on each payment, or upon each single admission. In the case of admissions by season ticket or subscription, the tax applies to the amount paid for each season ticket or subscription.
- 6. RETURNS AND PAYMENT OF TAX.**—(a) *Admissions.* Return with remittance covering taxes on admissions collected in any month must be in the hands of the Collector of Internal Revenue (or his authorized representative) of the district in which is located the place or business of the person making such return and payment on or before the last day of the month following that for which it is made. See Art. 41, Reg. 43, Part 1 (Revised), and footnote.
- (b) *Dues.* Return with remittance covering taxes on dues collected in any month must be in the hands of the Collector of Internal Revenue (or his authorized representative) of the district in which is located the principal office or place of business of the person making such return and payment on or before the last day of the month following that for which it is made.
- 7. CREDITS.**—In case of overpayment of tax due to an error in calculation, credit may be taken therefor upon any subsequent monthly return. Credit may also be taken as outlined in the regulations. A complete and detailed record of such overpayment must be kept by the person taking credit therefor. In case credit is taken on this return for an overpayment made on a previous return, full information must be attached showing the reasons therefor and designating the kind of tax, and the month for which the previous return was filed and the date of payment.
- 8. RECORDS.**—Every person or organization required to make a return must keep such records as will show all payments, admissions, or members upon which tax is required to be collected, in order that returns may be easily verified by revenue officers.
- 9. ADMISSION TICKETS.**—The price of the ticket shall be conspicuously and indelibly printed, stamped, or written on the face or back of that part of the ticket which is to be taken up by the management of the theater, opera, or other place of amusement, together with the name of the vendor, if sold other than at the ticket office of the theater, opera, or other place of amusement. Penalty of not more than \$100 for violation of the clause.
- 10. PENALTIES.**—Failure to file on time, 25 per cent of tax. Failure to pay on time, 5 per cent of tax and 1 per cent interest a month. Severe penalties for failure to file returns or for false or fraudulent returns.

UNITED STATES INTERNAL REVENUE  
Form 729—Revised Sept., 1922

## RECEIPT FOR PAYMENT OF TAX ON ADMISSIONS AND DUES

Month of \_\_\_\_\_, 192

THIS RECEIPT NOT TO BE DETACHED BY TAXPAYER

NOT VALID UNLESS RECEIPTED BY CASHIER

TAXPAYER WILL ENTER AMOUNT PAID IN THE SPACE PROVIDED THEREFOR

NAME AND ADDRESS	DATE PAID	AMOUNT PAID
	(CASHIER'S STAMP)	

8-51526a

[Reverse of Form 729 and tax receipt form.]



## TAX ON ADMISSIONS AND DUES REGULATIONS.

## REGULATIONS NO. 43 (REVISED)

## PART 2

(As amended to January 1, 1923.)

Relating to the

## TAX ON DUES

(Promulgated January 11, 1922.—Also designated as T. D. 3276.)

[Fully indexed at the end of this section.]

**6513 Article 1. Payments within time scope of the Act.**—The tax imposed under section 801 of the Revenue Act of 1921 applies only to amounts paid on or after January 1, 1922, "for any period after such date," as dues or membership fees, or as initiation fees, to any social, athletic, or sporting club or organization, provided such dues or fees are in excess of the amounts therein specified.

**6514** However, a tax at the same rate and on identically the same basis was imposed under section 801 of the Revenue Act of 1918. This tax became effective April 1, 1919, and dues or fees paid after January 1, 1922, for a period prior to that date and while the 1918 Act was in force are taxable thereunder. Dues and fees paid prior to January 1, 1922, but for a period after that date, are likewise taxable under the 1918 Act.

**6515 Art. 2. Rate and basis of tax.**—The rate of the tax imposed by the Revenue Act of 1921 is 10 per cent of any amount paid as dues or membership fees or as initiation fees to clubs or organizations coming within its provisions. It applies to any amount paid (a) as dues or membership fees where the dues or membership fees of an active resident annual member are in excess of \$10 per year; or (b) as initiation fees, if such fees amount to more than \$10, or if the dues or membership fees (not including initiation fees) of an active resident annual member are in excess of \$10 per year. Amounts paid for life memberships are not subject to the tax, but life members shall pay annually, at the time for the payment of dues by active resident annual members, a tax equivalent to the tax upon the amount paid by such a member. (See art. 11.)

**6516** If the dues or membership fees of an active resident annual member are in excess of \$10 per year, the tax applies to the entire amount paid either as dues or membership fees or as initiation fees. The fact that the tax does not attach to dues or membership fees, where the dues or membership fees of an active resident annual member are *not* in excess of \$10 per year, does not imply that exemption to the extent of \$10 applies where the dues or membership fees exceed this amount. In other words, no deduction is authorized in computing the tax due if the dues or membership fees are taxable under the Act.

**6517** Likewise, if the dues or membership fees of an active resident annual member are in excess of \$10 per year, amounts paid by other classes of members are taxable even though the dues or membership fees of such members are less than \$10 per year. (See art. 9.)

**6518 Art. 3. Clubs and organizations included.**—Dues or membership fees, or initiation fees, paid to any social, athletic, or sporting club or

## TAX ON ADMISSIONS AND DUES REGULATIONS.

organization, excepting fraternal societies, orders, or associations, operating under the lodge system (see art. 7), if in excess of the amounts specified by the Act, are subject in toto to the tax imposed by section 801. The Act includes not only "clubs" but also "organizations" of a social, athletic, or sporting character.

**6519 Art. 4. Determination of character of club.**—The purposes and activities of a club and *not its name* determine its character for the purpose of the Tax on Dues. Every club or organization having social, athletic, or sporting features is presumed to be included within the meaning of the phrase, "any social, athletic, or sporting club or organization," until the contrary has been proved, and the burden of proof is upon it. Every such club or organization, therefore, unless it falls within the express exemption of the Act (see art. 7, below), must collect, return, and pay over the tax imposed by the Act, unless and until it has satisfied the Commissioner of Internal Revenue that it is not in fact "social, athletic, or sporting" within the meaning of the Act as defined in these regulations. (See arts. 5 and 6, below.) If any such club or organization desires to claim that it is not in fact "social, athletic, or sporting" it shall submit to the collector its charter or constitution and by-laws, together with a statement as to its actual purposes, activities, practices, and facilities, the character of its expenditures, and such other evidence as may be requested. Upon consideration of the evidence submitted the collector will determine whether or not such club or organization is included within the provisions of the Act. If, however, the collector is in doubt as to whether or not the club or organization is "social, athletic, or sporting," he will refer the statement and accompanying papers to the Commissioner for decision. When a club or organization has been held not to be a "social, athletic, or sporting" club or organization, it need not thereafter make a return of tax on dues or fees, or any further showing with respect to its status under the law, unless it changes the character of its organization or operations or the purpose for which it was originally created. Collectors will keep a list of all clubs or organizations held not to be "social, athletic, or sporting" clubs or organizations, to the end that they may occasionally inquire into their status and ascertain whether or not they are observing the conditions upon which their exemption is predicated. If the collector decides that the club or organization is included within the provisions of the Act and the club or organization is not satisfied with his decision, it may request that the matter be referred to the Commissioner of Internal Revenue at Washington for a ruling, and this will be done. If the collector or the Commissioner decides that the club or organization is not included within the provisions of the Act, then on the filing with the collector to whom the tax has been paid of a properly prepared claim (see art. 15 below) on Form 46 (Revised), the amount of tax already paid to the collector will be refunded to the club or organization for repayment by it to the original taxpayers.

**6520 Art. 5. Social clubs.**—Any organization which maintains quarters or arranges periodical dinners or meetings, for the purpose of affording its members an opportunity of congregating for social intercourse, is a "social \* \* \* club or organization" within the meaning of the Act, unless its social features are not a material purpose of the organization but are subordinate and merely incidental to the active furtherance of a different and predominant purpose, such as, for example, religion, the arts, or business.

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WAR TAX 1308 SERVICE



The tax does not attach to dues or fees of a religious organization, singing society, chamber of commerce, commercial club, trade organization, or the like, merely because it has incidental social features, but, if the social features are a material purpose of the organization, then it is a "social \* \* \* club or organization" within the meaning of the Act. An organization that has for its exclusive or predominant purpose religion or philanthropic social service (or the advancement of the business or commercial interest of a city or community) is so clearly not a "social \* \* \* club or organization" that its possession and use of a building furnished with social-club facilities does not render taxable dues or fees paid to it. Most fraternal organizations are in effect social clubs, but if they are operating under the lodge system payments to them are expressly exempt. (See art. 7, below.)

**6521 Examples.**—(1) Neither a Young Men's Christian Association nor a Young Men's Hebrew Association is a social club within the meaning of the Act, for the predominant purpose of each is religion and philanthropic social service.

**6522** (2) A social settlement which provides, among other things, dances and other social opportunities for a slum neighborhood is supported by contributions. Any person contributing \$15 a year is called a "member" of the settlement association. Such contributions are not taxable, for such a settlement is not a social club within the meaning of the Act, as its predominant purpose is philanthropic social service.

**6523** (3) An automobile dealers' association is organized and operated for the purpose of maintaining a social organization of persons residing in a certain city and engaged in the manufacture or sale, or both, of automobiles and their accessories, and for the further purpose of affording its members opportunity and inducement to enjoy healthful indoor games, and to acquire skill and efficiency therein, and promote social welfare and social intercourse between the members, thereby promoting their mental and bodily health, and further by debates and discussions between themselves at their meetings promote interest in automobile transportation, traffic, and knowledge of the industry in the city, and also to enable its members to cooperate in holding an annual automobile show and in securing judicious and needed legislation for the protection and advancement of the automobile industry in the city. This organization is a social club within the meaning of section 801.

**6524 Art. 6. Athletic or sporting clubs.**—Tennis, golf, boxing, boating, canoe, fishing, and hunting clubs, and any organization (of which the members are individuals) for the practice or promotion of athletics or sports, are included within the meaning of the words of the Act, "athletic, or sporting club or organization." A local, sectional, or national "athletic or sporting" association, the membership of which is composed wholly or partly of member clubs, is not within the scope of the Act. The possession and use of a gymnasium, swimming pool, or other athletic facilities by an organization having religion or philanthropic social service for its exclusive or predominant purpose does not bring the organization within the class of athletic or sporting clubs or organizations.

**6525 Examples.**—(1) An intercollegiate athletic association, whose membership is composed not of individuals but of the track teams of a group of colleges, is not within the scope of the Act, and dues and fees paid to it by the member teams are not taxable.

## TAX ON ADMISSIONS AND DUES REGULATIONS.

**6526** (2) Dues and fees paid for membership in a Young Men's Christian Association or Young Men's Hebrew Association are not taxable, although they entitle the member to the use of a gymnasium, swimming pool, or other athletic facilities.

**6527** **Art. 7. Exempt organizations.**—The Revenue Act of 1921 expressly  
 6510 exempts from tax "all amounts paid as dues or fees to a fraternal society, order, or association, operating under the lodge system." "Operating under the lodge system" means carrying on its activities under a form of organization that comprises local branches, chartered by a parent organization and largely self-governing, called "lodges," "chapters," or the like.

**6528** *Examples.*—(1) An organization, formed for purely social purposes by Masons of the higher degrees, consisting of local "lodges" and a "grand lodge," falls within the exemption.

**6529** (2) Dues and fees paid to a "chapter" of a college fraternity are exempt from tax.

**6530** (3) Dues and fees paid to a "local" of a labor union are free from tax.

**6531** (4) A national organization, of a social, athletic, or sporting character, comprising no local bodies but organized as a single and nation-wide unit, to which each member belongs directly, does not fall within the exemption.

**6532** (5) Dues and fees paid by members of a local organization among the students of a college which is similar to chapters of the larger college fraternities are not exempt from tax.

**6533** **Art. 8. Foreign clubs.**—Dues or fees paid to a club located outside of the United States and having no branch or organization in the United States are not taxable.

**6534** **Art. 9. Dues or membership fees.**—The Revenue Act of 1921 imposes a tax of 10 per cent on any amount paid as dues or membership fees (including recurrent assessments, assessments for running expenses, and penalties incurred by failure to pay promptly) to any club which is within the terms of the Act: *Provided*, That the regular dues or membership fees (including recurrent assessments, and assessments for running expenses, levied upon all active resident annual members but not including penalties incurred by failure to pay promptly) of an "active resident annual member" of such club are in excess of \$10 per year. "An active resident annual member" is a member who is neither a life nor a nonresident member, but who in other respects enjoys full club privileges, as distinguished from the restricted privileges enjoyed by a person holding an associate or other partial membership. (This paragraph is as amended by T. D. 3285, Feb. 11, 1922.)

**6535** Thus in the case of a club or organization the regular dues or membership fees of which are less than \$10 per year, but which levies an assessment on its active resident annual members each year, if the regular dues or membership fees, plus the assessment, exceed \$10 per year, the tax is applicable. The tax would likewise apply in the case of a club or organization which collects no regular dues or membership fees but meets its expenses by levying assessments on its members as funds are required, provided, of course, the assessments aggregate more than \$10 per year for members who enjoy the full privileges of the club or organization.

**6536** Where the dues or membership fees, determined in the manner herein outlined, of an active resident annual member are in excess of \$10 per year, dues or membership fees paid by other classes of members,



## TAX ON ADMISSIONS AND DUES REGULATIONS.

whether or not they are in excess of \$10 per year, are subject to the tax. So, also are extra charges which are imposed upon members for the privilege of using certain additional facilities for a period of time, as, for example, an additional charge of \$60 per annum imposed upon members of a country club for the privilege of using the golf links. A "greens fee" charged to a guest is not taxable, unless the right or privilege granted in return is for a period of time, such as a season. A fine imposed for the violation of rules promulgated by a club or organization would be neither dues nor membership fees within the meaning of the Act, and therefore not taxable.

**6537** As to the time for payment of the tax, see article 12.

**6538** *Examples.*—(1) A certain social club has "members," nonresident members, associate members, and junior members. "Members" pay an initiation fee of \$15 and regular dues of \$10 per year. Associate members pay an initiation fee of \$10 and regular dues of \$5 per year. Nonresident members and junior members pay still less. In the case of this club a "member" is clearly the "active resident annual member" specified in the Act. As a "member's" regular dues are not in excess of \$10 per year, none of the dues or membership fees paid by any member of the club are taxable. (The initiation fee of \$15 paid by a "member" is taxable.)

**6539** (2) A certain athletic club had members, dues, and fees precisely the same as those of this social club, except that the initiation fee of "members" is \$10 and the regular dues of "members" are \$15 per year. As these dues are in excess of \$10 per year, in this case all dues paid to the club by members of any class are subject to tax.

**6540** (3) The same athletic club levies in a certain year, in addition to its regular dues, an assessment of \$10 on every associate member and provides a penalty of \$1 if it be not paid within a month after due. This assessment is taxable, and so is the penalty if it be imposed.

**6541** (4) A member of this same athletic club violates the house rules and is suspended until he pays a fine of \$15. As a fine is neither dues nor membership fees, this \$15 payment is not taxable.

**6542** (5) A certain golf club's dues are \$15 per year. Of this amount \$10 is expended in the purchase for the member of a season ticket to a municipal golf course. The whole \$15 is, nevertheless, taxable as dues.

**6543** (6) A certain golf club charges a "green" fee of \$1 for each guest that uses the course. Such a fee is not paid "as dues or membership fees," and is, therefore, not taxable as such.

**6544** (7) The members of a certain curling club pay annual dues of \$20. By the payment of \$10 extra per year the privilege of skating on the club's rink can be secured for the member's family. A payment of this extra \$10 is taxable as a membership fee.

**6545** (8) A certain social club, the regular dues of which are \$15 per year, has honorary members who pay no dues, but pay assessments when levied. Such members must pay tax on the amounts paid for assessments.

**6546** (9) A tennis club in which the annual dues are \$10, levies an assessment of \$2 per year on each member to cover cost of tennis balls. The dues, fees, and assessments paid by members of this club are taxable.

**6547** (10) A certain club, the dues and fees of which are taxable, requests a "subscription" of a definite amount from each resident member. Amounts paid by reason of such request are taxable.

**6548** (11) A social club, the annual dues in which are \$10, levies an assessment of \$5 on members. The tax applies with respect to amounts paid as dues, fees, and assessments.

## TAX ON ADMISSIONS AND DUES REGULATIONS.

**6549** (12) A certain social club, the dues and fees of which are taxable, passes a resolution providing that no membership dues or fees shall be collected from members who are in the military service of the United States. Such members thereafter pay no dues or fees and are therefore not liable for payment of tax with respect to membership in the club, but this does not relieve life members who are in the military service from payment of the tax on their life memberships.

**6550** (13) A certain golf club, the dues and fees of which are taxable, issues to wives of members cards entitling them to the use of the course for one year, making a charge of \$10 therefor. The amounts paid for such cards are taxable.

**6551** (14) The membership of a certain social club is composed of its stockholders. No dues are collected, but the expenses of the club are met by annual assessments of the necessary amount on each share of stock. If a stockholder enjoying full privileges of the club must pay assessments aggregating more than \$10 per year, then the tax applies with respect to all payments made to the club by any stockholder, whether in excess of \$10 per year or not.

**6552** **Art. 10. Initiation fees.**—Any amount paid as initiation fees to a club or organization coming within the provisions of section 801 of the Act is subject to the 10 per cent tax imposed thereunder (a) if such fees amount to more than \$10, or (b) if the dues or membership fees (not including initiation fees) of an active resident annual member are in excess of \$10 per year.

**6553** If the prescribed initiation fees amount to more than \$10, the tax attaches regardless of the amount of dues or membership fees paid by an active resident annual member. On the other hand, if the initiation fees amount to less than \$10, the tax does not apply unless the dues or membership fees, exclusive of initiation fees, of an active resident annual member are in excess of \$10 per year. If such dues or membership fees are in excess of \$10 per year any amount paid as initiation fees is taxable whether or not such initiation fees amount to more than \$10.

**6554** Where the application of the tax to initiation fees depends upon the amount paid as dues or membership fees by an active resident annual member, recurrent assessments, and assessments for running expenses (but not penalties incurred by failure to pay promptly) are to be considered in ascertaining whether such dues or membership fees are in excess of \$10 per year. (This paragraph is as amended by T. D. 3285, Feb. 11, 1922.)

**6555** The term "initiation fee" includes any payment to the club required for becoming a member, whether evidenced by a certificate of membership or a share of stock in the club or not. Thus, it includes amounts paid to such clubs or organizations for stock where the purchase of such stock is required as a prerequisite of membership. This applies only to stock purchased from the club or organization and not to amounts paid for stock purchased from retiring members or other sources.

**6556** *Examples.*—(1) In the case of the social club described in the first example of article 9, above, an initiation fee paid by a "member" is taxable because it amounts to more than \$10, but initiation fees paid by members of the other classes are not taxable.

**6557** (2) In the case of the athletic club described in the second example in article 9, above, initiation fees paid by members of any class are taxable, because the regular dues of "an active resident annual member" are in excess of \$10 per year.

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## TAX ON ADMISSIONS AND DUES REGULATIONS.

or March 1, July 1, and November 1, or April 1, August 1, and December 1, depending on the date on which the voting member was admitted to membership. If any installment is not paid on or before the 15th day of the month in which it is due a penalty of \$2 must also be paid. In this case each life voting member must pay (to the *club*, for the Government imposes on *it* the duty of collection) a tax of \$1 on May 1 and September 1, 1922, and on January 1, 1923, etc. If any one of these taxes is not paid to the club on or before the 15th day of the month in which it is payable, the tax will be \$1.20 instead of \$1. If it happens that an assessment of \$20, in addition to the regular dues and payable November 15, 1922, is levied on the voting members, then a tax of \$2 from each life voting member must also be paid on that date to the club. If the \$500 life voting membership fee was paid before November 1, 1917, or on or after April 1, 1919, it is not itself taxable, but if paid on or after November 1, 1917, and before April 1, 1919, it is subject to a tax of \$50 under the Revenue Act of 1917.

**6565** (2) A certain golf club has two classes of members, life members and "members." A life member pays \$1,000 on admission and is exempt from dues. A "member's" dues are \$60 a year, a \$30 installment for January—June being payable April 1, and a \$30 installment for July—December being payable October 1. In the case of this club it is clear that a "member" is the "active resident annual member" specified in the Revenue Act of 1921. John Smith is elected a life member of this club in February, 1919, and in that month pays his \$1,000 fee and a tax of \$100 thereon, under the Revenue Act of 1917. Under the Revenue Acts of 1918 and 1921 he will have to pay (to the *club*, for the Government imposes on *it* the duty of collection) on April 1, 1919, a tax of \$1.50, and on October 1, 1919, April 1, 1920, etc., a tax of \$3—the same taxes as those Acts impose on a "member."

**6566** (3) A certain social club has three classes of members, life members, active members, and associate members. The regular dues of the active members (clearly the "active resident annual members" specified in the Revenue Act of 1921—see art. 9, above) are \$10 per year. Edwin Boyle became a life member in 1916, paying a fee of \$100. That payment was not taxable. Nor does he have to pay any annual tax under the Revenue Act of 1921. For by that Act he is to pay the same annual tax as "an active resident annual member," and as the regular dues of "an active resident annual member" are not in excess of \$10 per year, such a member pays no tax whatsoever. (See art. 9, above.)

**6567** (4) A certain club the dues and fees of which are taxable has life members who do not avail themselves of the privileges of membership. Each of such life members must pay the tax imposed by section 801 of the Revenue Act of 1921 so long as he holds a life membership in the club.

**6568** (5) A certain social club the dues and fees of which are taxable passes a resolution providing that no membership dues or fees shall be collected from members who are in the military service of the United States. Such members thereafter pay no dues or fees and are therefore not liable for payment of tax with respect to membership in the club, but this does not relieve life members who are in the military service from payment of the tax on their life memberships.

## COLLECTION, RETURN, AND PAYMENT OF TAX.

**6569** Art. 12. Duty to collect, return, and pay tax.—Every club, organization, corporation, partnership, or individual receiving any taxable payment for dues or fees must, at the time of such receipt, collect the tax from the person making such payment. And there rests on such person the



## TAX ON ADMISSIONS AND DUES REGULATIONS.

corresponding duty of then paying such tax. Where the dues or membership fees are payable in periodical installments, the tax shall be collected as and when each installment is paid. In the case of recurrent assessments, and assessments for running expenses, the tax is due and shall be collected and paid when such assessments are paid. The tax on initiation fees is due and payable at the time of payment of such fees. (This paragraph is as amended by T. D. 3285, Feb. 11, 1922.)

**6570** Every club or organization having life members taxable under the Revenue Act of 1921 must collect from such life members the tax imposed on them by that Act. And such life members must, on their part, promptly pay such tax. It shall be collected and paid "at the time for the payment of dues by active resident annual members." Thus, if the dues or membership fees of an active resident annual member, or if another designation is used, the member whose privileges correspond to those usually enjoyed by active resident annual members (see art. 9), are payable in periodical installments the tax due from life members becomes due and shall be collected and paid as and when these installments are paid. If recurrent assessments or assessments for running expenses are levied on active resident annual members, there shall be collected from life members at the time such assessments are paid a tax equivalent to 10 per cent of the amount so paid. (This paragraph is as amended by T. D. 3285, Feb. 11, 1922.)

**6571** A monthly return and payment of all taxes collected must be made in accordance with the provisions of article 13, below.

**6572 Art. 13. Records, returns, and payments.**—Every "social, athletic, or sporting club or organization," unless expressly exempted from the Tax on Dues, or unless free from that tax because neither the initiation fees of any class of its members nor the regular dues or membership fees of an "active resident annual member" exceed \$10 per year, shall keep an up-to-date record showing the number of its members of each class. It shall also keep a record in which shall be entered each day (1) under the head of "Life membership:" (a) the number of life members from whom a life membership tax has been collected on that day, and (b) the total amount of tax so collected; and (2) under the head of each other class of membership: (a) the number of members of that class paying on that day dues or membership fees or initiation fees, (b) the total amount so paid by members of that class, and (c) the total amount of tax collected on such payments. Every such club or organization shall make up each month from this daily record a return in duplicate on Form 729 (revised), in accordance with the instructions printed on the back of that form. This return must be made under oath, unless the amount of the tax returned is \$10 or less, in which case it may be signed or acknowledged before two witnesses instead of being under oath. This return together with the amount of the tax must be in the hands of the collector of internal revenue of the district in which is located the principal office or place of business of the person making such return and payment, on or before the last day of the month following that for which it is made. (For penalties see art. 17, below.) A copy of Form 729 (revised) [page 1305] will, as far as possible, be mailed each month to every club or organization that filed a return for the preceding month, but a failure to receive such copy will not, of course, excuse a failure to return and pay the tax. A return must be made for each month whether or not taxable dues or fees have been collected. Where a club has no tax to report during any month, this fact should be noted on the return filed for that month. The records above described shall be preserved in the

## TAX ON ADMISSIONS AND DUES REGULATIONS.

office of the club or organization for a period of two years in such a manner as to be readily accessible on request to internal revenue officers.

**6573** *Examples:* (1) A member of a club the dues and fees of which are taxable fails to pay his dues and is carried for a specified time before being expelled. Such member is not liable for payment of tax with respect to unpaid dues so long as they remain unpaid, but should the club succeed in collecting dues covering the period during which the member was delinquent it must account for the tax.

**6574** (2) A member of a club the dues and fees of which are taxable refuses to pay the tax to the club. The club should report the case to the collector of internal revenue for the district in accordance with article 17 of these Regulations. There is, however, nothing in the law to prevent a club paying the tax for its members if it desires to do so.

**6575** **Art. 14. Credit to club for overpayment.**—If a club, organization, corporation, partnership, or individual overpays or overcollects the tax due with one monthly return, credit for the overpayment or overcollection may be taken against the tax due with a succeeding return. In case a credit is claimed, a statement shall be attached to the return setting forth fully the facts regarding the alleged overpayment or overcollection. In the case of the overcollection of a tax, no credit for the amount overcollected shall be allowed until the club, organization, corporation, partnership, or individual making the overcollection submits a sworn statement showing that the tax in each case so overcollected has been returned to the person making the overpayment, that no claim for a refund of any such amount has been filed with the collector or Commissioner on behalf of any of the members who paid such amounts, and a complete list of such members.

**6576** **Art. 15. Refund of overpayment.**—Any club, organization, corporation, partnership, or individual that has paid to the collector of internal revenue, as a tax under section 801 of the Revenue Act of 1918, or section 801 of the Revenue Act of 1921, any amount erroneously or illegally assessed, or any amount in excess of the amount of the tax actually imposed by those sections for the month covered by that payment, or any amount as a penalty for the collection of which there was no authority, may secure a refund of the amount so overpaid by filing with the collector to whom such payment was made a properly prepared claim on Form 46 (revised). When a club or organization seeks to secure a refund to it of an amount collected by it from its members and then paid over by it to the collector of internal revenue, the claim on 46 (revised) must be accompanied by a list of members who paid such amount and by a sworn statement of a club officer that no claim for a refund of any such amount has been filed with the collector or Commissioner on behalf of any such members. [Form 843 instead of Form 46.]

**6577** **Art. 16. Refund by club of overcollection.**—Every club, organization, corporation, partnership, or individual that has collected from any person, as a tax under section 801 of either the Revenue Act of 1918, or of 1921, any amount erroneously or illegally assessed, or any amount in excess of the amount of the tax imposed by that section actually due from such person, shall upon proper application promptly refund such amount to the person entitled thereto, even though such amount has already been paid over to the collector of internal revenue and no corresponding credit (see art. 14, above) or refund (see art. 15, above) has yet been secured.



## TAX ON ADMISSIONS AND DUES REGULATIONS.

6578

## PENALTIES

<i>Act or Default Penalized</i>	<i>Penalty Applicable</i>	<i>Section of Revenue Act of 1921</i>
"Failure to make and file" return "within the time prescribed" (when return not filed later and reasonable cause shown for failure to file in time).	25 per cent addition to tax (to be collected as part of tax or if tax already collected then in same manner as tax).	Section 3176, U. S. Revised Statutes, as re-enacted by section 1311.
Willfully making "false or fraudulent return."	50 per cent addition to tax (to be collected as above).	Do.
Failure to pay tax when due.....	5 per cent addition to tax and 1 per cent interest for each full month from time tax due.	502 (d).
Failure by any "person"* to "pay, collect, or truly account for and pay over any such tax, make any such return or supply any such information at the time or times required by law or regulation."	Penalty of not more than \$1,000.	1302 (a).
Willful refusal by any "person"* to "pay, collect, or truly account for and pay over any such tax, make such return or supply such information at the time or times required by law or regulation," or willful attempt "in any manner to evade such tax."	Fine of not more than \$10,000, or Imprisonment for not more than one year, or both.	1302 (b).
Willful refusal by any "person"* to "pay, collect, or truly account for and pay over any such tax."	100 per cent addition to tax.†	1302 (c).

\*"Person" includes "an officer or employee of a corporation or a member or employee of a partnership, who as such officer, employee, or member is under a duty to perform the act in respect of which the violation occurs." (Section 1302 (d) [§8017].)

†"No penalty shall be assessed under this subdivision for any offense for which a penalty may be assessed under authority of section 3176 of the Revised Statutes, as amended," the substance of which is stated above. (Section 1302 (c) [§8016].)

**6579 Art. 17. Penalties.**—The scope of the penalties applicable to the Tax 5509 on Dues is so broad that reference will be made only to their most 8014 common applications. Every club or organization, on which there 8071 rests a duty (see art. 13, above) to file a monthly return on Form 729 (revised), that fails to file such return, and to pay over the tax due thereon, during the month which follows that for which such return should be made, is subject to certain automatic penalties. A mere failure to file the return within the following month causes to automatically accrue the 25 per cent penalty imposed by section 3176 of the Revised Statutes, as amended. The 50 per cent penalty computed on the total tax liability accrues when the return filed is false or fraudulent. A mere failure to pay over the tax within

the month following its receipt by the club or organization causes to automatically accrue, under section 502 (d) of the Revenue Act of 1921 [¶5509], a penalty of 5 per cent, and of interest at 1 per cent per month for each full month of delay. Every club member who fails to pay to his club at the proper time the amount of the tax on his dues or fees and every club or organization which fails to collect or truly account for and pay over such tax (see art. 13, above) is subject, under section 1302 of the Revenue Act of 1921. [¶8014], to a penalty of not more than \$1,000. If this failure amounts to a willful refusal to pay or an attempt to evade the tax on the part of the club member, or a willful refusal to collect or truly account for and pay over such tax on the part of the club or organization, such willful refusal subjects the offender to a fine of not more than \$10,000, or imprisonment for not more than one year, or both, and in addition a penalty of 100 per cent of the amount of the tax (see secs. 1302 (b) and (c) of the Revenue Act of 1921). It is the duty of the club officer who has charge of the collection of dues and fees to report to the collector of internal revenue the name and address of any member who refuses to pay his tax, together with the amount of the tax and such other information as will enable the collector to cause a proper investigation to be made.

**6580** *Example.*—A certain social club collects \$1,000 of taxable dues each month, but carelessly fails to file a return for April, May, and June, 1922, until September 2, 1922. The taxes and automatically imposed penalties then due for those months would be as follows:

April tax.....	\$100.00	
25 per cent penalty.....	25.00	
5 per cent penalty.....	5.00	
3 months' interest.....	3.90	
		\$133.90
May tax.....	100.00	
25 per cent penalty.....	25.00	
5 per cent penalty.....	5.00	
2 months' interest.....	2.60	
		132.60
June tax.....	100.00	
25 per cent penalty.....	25.00	
5 per cent penalty.....	5.00	
1 month's interest.....	1.30	
		131.30
Total of taxes and penalties.....		\$397.80

**6581** In addition the club would be liable to a penalty of not more than \$1,000.

### AUTHORITY FOR REGULATIONS

**6582** **Art. 18. Promulgation of regulations.**—In pursuance of this provision of the Act the foregoing regulations are hereby made and promulgated and all rulings inconsistent with them are hereby revoked.

C. P. SMITH,

*Acting Commissioner of Internal Revenue.*

Approved January 11, 1922. [Released for publication Jan. 23, 1922.]

A. W. MELLON,

*Secretary of the Treasury.*



**TAX ON ADMISSIONS AND DUES REGULATIONS.****6583**

to

**6588****REGULATIONS NO. 43 (REVISED)****PART I.**

(As amended to January 1, 1923.)

Relating to the

**TAX ON ADMISSIONS**

(Promulgated February 15, 1922. Also designated as T. D. 3293.)

[Fully indexed at the end of this section.]

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## TAX ON ADMISSIONS AND DUES REGULATIONS.

## CHAPTER ONE

## Taxes on Admissions

**6589** Art. 1. Basis, rate, and computation of tax.—Any amount, if in  
 6500 excess of 10 cents, paid for admission to any place (see Art. 2) is  
 6501 subject under these provisions of the Act to a tax of 1 cent for each  
 10 cents or fraction thereof of the *whole* amount so paid, which tax  
 is to be paid by the person paying for such admission. This tax applies to  
 the *payment* for admission, not to the *admission* itself, and as soon as payment  
 for admission is made the tax applies, whether or not the admission itself  
 ever takes place.<sup>1</sup> And the tax applies if the payment for admission occurs  
 in the United States, even though the *admission* is to take place outside the  
 territorial limits of the United States. No refund of the tax can be allowed  
 by reason of nonuser unless the admission charge also is refunded (see Art. 45).

**6590** The tax applies to the amount paid for each admission separately,  
 and, therefore, if two or more admissions are paid for at once, the  
 total tax is determined by computing separately the tax on each admission  
 and by then adding together the taxes so obtained. In other words, the tax  
 for 10 single admissions will always be 10 times the tax for each single admis-  
 sion. In the case of season tickets or subscriptions which entitle the holder  
 or subscriber to more than one admission the tax is computed on the amount  
 paid without regard to the number of admissions involved. However, if  
 two or more season tickets are paid for at the same time, the tax would be  
 computed on each ticket separately, and the same rule would apply to sub-  
 scriptions.

**6591** Where a single charge is made to cover admission to more than  
 one attraction under the same management the tax is computed on  
 the basis of such charge. If separate charges are made for each attraction,  
 the tax is computed on each such charge. For example, if a circus issues a  
 combination ticket entitling the holder to admission and to the use of a  
 reserved seat for \$1.50 the tax due is 15 cents, whereas if separate tickets  
 for admission and for a seat are sold for 75 cents each, the tax on each charge  
 would be 8 cents, making a total of 16 cents.

**6592** The amount paid for admission to any place is the amount which  
 must be paid to the person controlling such admission in order to  
 secure that privilege. If a ticket or card of admission is sold by the person  
 controlling said admission for an amount in excess of the regular or established  
 price or charge therefor, the tax imposed by section 800 (a), paragraph (1),  
 will apply to the entire amount for which it is so sold. In addition the theater  
 or other place of amusement (or broker) selling such ticket or card of admission  
 for an amount in excess of the regular or established price therefor will be  
 subject to a tax on the amount of the excess charge. (See Chapter Four.)

**6593** Art. 2. Meaning of the term "place."—The tax under these provi-  
 sions of the Act is on "the amount paid for admission to any place."  
 "Place" is a word of very broad meaning, and it is not defined or otherwise  
 limited by the Act. But the basic idea it conveys is that of a definite location.  
 The phrase, therefore, "to any place" does not narrow the meaning of the  
 word "admission," except to the extent that it implies that the admission

<sup>1</sup> The Act applies generally only to the mainland of the United States, Hawaii, and Alaska.

## TAX ON ADMISSIONS AND DUES REGULATIONS.

is to a definite location on or beneath the surface of the earth, or to a structure whose location with relation to the earth is definitely fixed, at least temporarily. The "place" need not be within the territorial jurisdiction to which the act is applicable, for as has been noted (Art. 1) the tax applies to the *payment*, not to the admission. Places of amusement obviously constitute the most important class of places admission to which is subject to this tax.

**6594** *Examples.*—(1) Each of the following is a "place" within the meaning of the Act:

(a) An outdoor amusement park, and such attractions therein as a scenic railway, a merry-go-round, a roller coaster, a Ferris wheel, a toboggan slide, a bump-the-bumps, a whip, a dip-the-dips, a speed-plane, a hilarity hall, and a dance hall.

(b) An observation tower on top of a high building.

(c) A grandstand built for the purpose of viewing a parade passing in the street or a baseball game in an adjoining baseball park.

(d) A cave.

(e) A space inclosed in which are seats from which to watch the bathing along the beach.

(f) A floating theater operating along a river, anchored or moored for each performance.

**6595** (2) None of the following is a "place" within the meaning of the Act:

(a) A railway car (unless rendered stationary by sidetacking or removal from track).

(b) A street car (unless rendered stationary by sidetracking or removal from track).

(c) A steamboat (unless anchored or moored).

(d) A sight-seeing automobile.

(e) A railroad train or a boat following the course of a boat race.

**6596** (3) Where an admission charge is made to a dancing pavilion and an additional charge is made, in the case of each dance, for admission to the dancing floor within this pavilion, admission to the dancing floor (as well as admission to the pavilion) is admission to a "place" within the meaning of the Act.

**6597** (4) A tennis tournament is a contest and not a "place" and, therefore, an amount paid by a player to "enter" such a tournament is not "paid for admission to any place" within the meaning of the Act. On the other hand, the grandstand at the tennis tournament is a "place" within the meaning of the Act.

**6598** (5) Amounts paid for rides in an airplane making exhibition flights are not taxable. It is not material that the flights start and terminate in a fair ground. Amounts paid for admission to a building or other inclosure to view an airplane are, however, taxable.

**6599** (6) Admissions to the amusements called "shoot-the-chutes" and "the Old Mill" are taxable. A charge for admission to small boats operated and propelled by means of a current of water confined to a narrow channel which determines the course and direction of the boats, is taxable as an admission to a place. However, an amount paid for a ride on a boat in an open lake or stream where the boat may be steered in any direction or take any course desired is not taxable.

**6600** As to the application of the tax where the charge includes the rental of property or services, see Article 4.



## TAX ON ADMISSIONS AND DUES REGULATIONS.

**6601** Art. 3. Meaning of "admission."—The tax is imposed on "the  
**6507** amount paid for admission to any place." It applies only to amounts in excess of 10 cents which *must be paid* in order to gain admission to a place (see Art. 1). Hence the tax will not apply to voluntary contributions where no payment is required for admission to such place nor to payments made under certain other conditions (for which see Art. 5). The term "admission" primarily means being permitted the right or privilege to enter into a place. However, the Act specifically provides that it shall also include "seats and tables, reserved or otherwise, and other similar accommodations." A charge for their use, therefore, in any place, must be treated as a taxable charge for admission, and not as a rental charge, which would escape those taxes. (See Art. 4.) So an amount paid for the right to use a reserved seat in a theater or circus, a table in a roof garden, a seat in a hotel room or window to view a parade, or the like, is taxable. This is true whether the charge made for the use of the seat, table, or similar accommodation is combined with an admission charge proper to form a single charge, or is separate and distinct from an admission charge, or is itself the sole charge.

**6602** Where an original admission charge carries the right to remain in a place, or to use a seat, table, or other similar accommodation for a limited time only, and an additional charge is made for an extension of such time, the extra charge is paid for "admission" within the meaning of the Act. For instance, amounts paid for second or repeat rides on roller coasters and merry-go-rounds are paid for "admission." Other examples which will illustrate the principle stated herein follow:

**6603** Examples.—(1) Where 75 cents is paid for general admission to a circus and then 50 cents is paid for a reserved seat, the latter amount, equally with the former, is "paid for admission" within the meaning of the Act.

**6604** (2) Where \$10 is paid to a hotel to reserve a table for celebrating New Year's eve, this amount is "paid for admission" within the meaning of the Act.

**6605** (3) An amount paid for the use of a swinging beach chair at a coast resort is not "paid for admission" within the meaning of the Act unless it is located in a space so enclosed or set apart as to constitute a place. (See Art. 2.)

**6606** (4) An amount paid for the use of a rolling or movable chair to be moved at the will of the occupant, no definite limits of space being set, is *not* "paid for admission to any place" within the meaning of the Act. (See Art. 2.)

**6607** (5) While the use of a seat must be considered an "admission" within the meaning of the Act, an amount paid for a seat in a parlor car is not an "amount paid for admission to any place," because a parlor car is not a place within the meaning of the Act. (See Art. 2.)

**6608** Art. 4. Charges for rental of property or services.—The provisions of this article do not relate to charges for "seats and tables . . . and other similar accommodations," which by the express terms of the Act are taxable as admissions (see Art. 3). Reference is here made to charges which are designated as rental or service charges, but which in fact may or may not represent, in whole or in part, admissions within the provisions of the Act.

**6609** These charges are of two general classes, viz: (A) where there is a single undivided charge, and (B) where there are separate and

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distinct charges designated for admission and for rental or services. These will be considered in the order named.

**A. Where There Is a Single Undivided Charge**

**6610** A charge imposed on a person admitted to a place which is not in fact or name an admission charge, but is a *bona fide* charge for the rental of real or personal property or equipment, or for personal services, is not taxable. If a charge involving rental or service is designated as an admission charge it will be presumed that it is in fact a charge for admission. The tax will apply in such case unless it is conclusively proven that the charge, in whole or in part, is for rental or service, and the burden of proof will rest on the person asserting that it is of such a character. On the other hand, the designation of a charge as a rental or service charge will not avoid the application of the tax if it in fact represents a charge for admission. In such cases the following rules will be applied in determining the true character of the charge:

**6611** (1) If the charge actually includes the right to use property or equipment or the right to services, and applies only to persons availing themselves of the use of the property, equipment, or services provided, other persons being admitted free or not admitted at all, the tax does not apply.

**6612** (2) If the charge (a) does not involve rental or service, or (b) is clearly unreasonable and excessive, the tax applies.

**6613** (3) If persons are admitted who are not permitted to use property or equipment or avail themselves of the services afforded others, and persons so admitted are required to pay the same charge as is imposed on persons to whom property, equipment, or services are furnished, the tax applies to amounts paid by all persons admitted.

**6614** (4) If persons not permitted to use property or equipment, or to avail themselves of services, are required to pay a lesser charge than persons who are furnished property, equipment, or services, this lesser charge is taxable as an admission.

**6615** In the situation outlined in the preceding paragraph, such part of the charge exacted from persons using property, equipment, or services as equals the charge imposed on persons not using such property, equipment, or services is deemed to represent an admission charge and is taxable as such.

**B. Where There Are Separate and Distinct Charges**

**6616** In cases where there is a charge (whether called an admission charge or not) generally applicable to persons admitted to a place, and also one or more *bona fide* separate charges for rental or services, as the case may be, then only the amount paid for the generally applicable charge is "paid for admission" within the meaning of the act.

**6617** *Examples.*—(1) Where a charge is made for admission to a building or inclosure in which a roller or ice skating surface is located, such charge is taxable the same as an admission to any other place of amusement regardless of whether or not persons paying the charge are also furnished with skates and admitted to the skating surface without the payment of an additional amount. Therefore, where the manager of a skating rink makes a single charge of 50 cents for admission to a building or inclosure, the skating surface, and for the use of skates, the tax to be collected in this case is 5 cents.



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The same tax would be payable on this charge if it covered admission to the building or inclosure only.

**6618** The building or inclosure in which the skating surface is located and the skating surface proper are separate places within the meaning of the law. Therefore, where single charges are made for admission to the building and the skating surface, the latter charge including the rental of skates, both charges are taxable as amounts paid for admission. For example, if a charge of 25 cents is made for admission to the building or inclosure and another charge of 25 cents covering rental of skates and admission to the skating surface, the tax to be collected is 3 cents on each charge.

**6619** Where bona fide separate charges are made for admission to the skating rink, skating surface, and for rental of skates, and persons using their own skates are required to pay the first two charges and no more, the tax attaches only with respect to the admission charges. For example, where 20 cents is charged for admission to the rink, 10 cents for admission to the skating surface, and 30 cents for skate rental, tax would not attach to the skate rental charge.

**6620** Where no charge is made for admission to the skating rink and a single charge covers rental of skates and admission to the skating surface, tax attaches to the entire amount of this charge.

**6621** Where a charge is made for admission to the skating rink and separate charges are made for rental of skates and admission to the skating surface, the admission charges only are taxable provided persons using their own skates are required to pay the admission charges and no more.

**6622** Whether a charge is made to the rink or not where persons using their own skates are not required to pay as much for admission to the skating surface as the charge exacted from persons who rent skates from the rink, the charge for admission to the skating surface shall be deemed to be the amount paid by persons using their own skates. For example, where 10 cents is charged for admission to the rink (or where no charge is made for admission to the rink), 10 cents for admission to the skating surface, and 30 cents for rental of skates—but a person using his own skates is required to pay 25 cents—the established price for admission to the skating surface is 25 cents.

**6623** (2) A certain golf club charges guests and other nonmembers a "green fee" of \$2 for each time they play on its course. This charge is not taxable as an amount paid for admissions.

**6624** (3) In a certain amusement park is a tennis court which is rented for 50 cents per hour. This charge is clearly a rental charge for the use of the court and is not "paid for admission" within the meaning of the Act.

**6625** (4) A certain bathing establishment at a coast resort makes a "rental" charge of 50 cents, for which it furnishes a bathing suit, towel, and a dressing room. The patrons bathe in the ocean from an uninclosed beach. Here the 50 cents is clearly for rental and is not "paid for admission" within the meaning of the Act.

**6626** (5) A 50-cent charge is made to everyone going out on a certain fishing pier. This charge covers the use of fishing tackle. No one is allowed on the pier unless he fishes and everyone must pay the full charge whether he uses his own fishing tackle or not. In this case the amount paid is clearly "paid for admission" within the meaning of the Act.

**6627** (6) A certain dancing school charges admission and an additional fee, which is reasonable, for "instruction." It is only imposed on persons desiring dancing instruction. This instruction charge is evidently

paid for services and so is not "paid for admission" within the meaning of the Act.

**6628** (7) The charge for "admission" to a certain dance is only \$1 per person, but each person is charged by the management a "hat-checking fee" of 50 cents. This checking charge is so clearly unreasonable that the whole amount (\$1.50) must be treated as an "amount paid for admission" within the meaning of the Act.

**6629** (8) The manager of a dancing academy permits persons attending classes to dance either with instructors or with other patrons of the academy. Amounts paid by all patrons, including those attending as students, are taxable as admissions.

**6630** (9) The manager of a so-called dancing academy employs a number of young ladies whom he pays a nominal sum for their services as dancing partners. Gentlemen are charged \$1 for the privilege of dancing and ladies are permitted to dance free. The charges made to gentlemen under these circumstances must be regarded as amounts paid for admission within the meaning of the Act, and the manager must collect a tax of ten cents from each gentleman admitted to the dance hall.

**6631** (10) Where 25 cents an hour is charged for the use of a rowboat on a pond in an amusement park, this amount is clearly paid for rental and is not an "amount paid for admission" within the meaning of the Act.

**6632** (11) Where a child pays 25 cents for a "ride" around a track on a pony, the amount paid is clearly for the rental of the pony or the services of the attendant, or both, and is not an "amount paid for admission" within the meaning of the Act.

**6633** (12) A certain bath establishment makes a charge of \$1 for a "Turkish bath" and does not allow anyone not taking such a bath to enter the Turkish bath section of its establishment. This charge is clearly not an "amount paid for admission" within the meaning of the Act.

**6634** (13) An amount paid for the use of a seat in the window of a hotel room, in order to watch a parade, would clearly be an amount paid for rental were it not that section 800 (c) of the Act expressly provides that the use of "seats and tables, reserved or otherwise, and other similar accommodations," is included in the meaning of "admission" as used in the Act. In view of this provision of the Act such an amount must be treated as "paid for admission." If the whole room were rented, however, it is clear that the amount paid for it would not be "paid for admission."

**6635** (14) A certain dance hall makes no charge for "admission" but forces everyone entering to pay 25 cents for "hat check privilege." The amount paid is clearly an "amount paid for admission."

**6636** (15) A sanitarium makes a charge of 50 cents for the privilege of swimming in pools filled with medicated water and does not allow anyone not using the pools to enter that part of the establishment. This charge is not an amount paid for admission within the meaning of the Act.

**6637** Art. 5. Nontaxable payments.—As stated in Art. 3, the tax imposed under section 800 of the Act applies only to amounts necessarily paid in order to gain admission to a place. Under peculiar circumstances amounts may apparently be paid for admission to a place, or in connection with such admission, which are not taxable as admissions. Instances in which this situation may arise, with examples to illustrate the principle involved, follow:



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## A. Cooperative Parties

**6638** Where a group or organization of persons cooperate in giving a dance or other function for its own entertainment, and the expenses are prorated amongst the members of such group or organization, the amounts paid under such an arrangement are not "paid for admission" within the meaning of the Act. Such payments represent each individual's share of the rental and services constituting the expense of the affair and are not taxable. The fact that a limited number of persons, outside of the group or organization, are invited to attend as free guests or that the individual share of the expense is fixed at an even figure will not make the tax apply if the affair is truly a cooperative party of the character above described. But if any guests are required or allowed to pay, or if any profit is sought or divided, then any amounts paid by the organizers or guests are paid for admission within the meaning of the Act, and are subject to tax.

**6639** *Examples.*—(1) A men's bowling club decides to give a dance on a certain night and circulates a list to be signed by all members who care to attend. On securing the names and estimating the expenses, the share of each member is fixed at \$2. (No charge, of course, is to be made to the partners brought by the members.) The dance is held without the use of tickets. The expenses proved to be less than expected, and there is a balance left on hand. This balance is refunded pro rata to those who paid \$2. In this case it is plain that the amounts paid by the members are not "paid for admission" within the meaning of the Act.

**6640** (2) A young men's club conducts a series of monthly dances and through friends and acquaintances establishes a mailing list of persons to whom invitations are sent each month. A charge of \$2 is imposed on each couple who attend, though no tickets are used. That amount is clearly an "amount paid for admission" within the meaning of the Act.

**6641** (3) A certain social club sends out to its members and certain non-members invitations and tickets to a musicale, the price of the tickets being \$1.50 each. Such a ticket is necessary to secure admission to the musicale. In this case the \$1.50 is clearly an "amount paid for admission" within the meaning of the Act.

**6642** (4) A group of 10 young men desire to give a dance and propose to defray the expenses by selling 100 \$2 tickets. Each member agrees to sell 10 tickets or to pay the full price thereof. A payment of \$2 for such a ticket is clearly an "amount paid for admission" within the meaning of the Act.

## B. Rental of Entire Place

**6643** Where a person or organization acquires the sole right to use any place or the right to dispose of all the admissions to any place for one or more occasions, the amount paid for such right is not subject to the tax on admissions. Such a transaction constitutes a rental of the entire place and of the attraction, if any, whether or not it is so designated. However, if the person or organization in turn sells admissions to the place the tax will apply to amounts paid for such admissions (see Art. 42).

**6644** *Examples.*—(1) A local lodge, desiring to entertain the delegates to a national convention of its order, contracts with a theater to pay \$1,200 for its entire seating capacity for a particular performance in the course of a long run of an attraction. This transaction is in effect a rental

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of the theater and the attraction for that performance and the \$1,200 is not an "amount paid for admission" within the meaning of the Act. As to the position occupied by the lodge with respect to admissions to the performance in question, see Art. 42.

**6645** (2) A certain public dance hall, where public dances are held every night by its proprietors, is rented by them to a certain social club for a certain night for \$150. The club charges its members the same fee as that charged by the proprietor of the hall on other nights. The \$150 is *not* an "amount paid for admission," but the amount paid by each member is an "amount paid for admission," within the meaning of the Act.

## C. Purchase of Property

**6646** In some cases entrance to a place is granted only to such persons as have made a purchase of property of some sort, which must be exhibited to secure admission, but which is not taken from the holder on his admission. In such a case, unless the sale appears, by reason of the undesirability or lack of value of the article, to be a mere subterfuge, the amount paid for such article is not an "amount paid for admission" within the meaning of the act.

**6647** *Examples.*—(1) Where a person, in order to be admitted to an entertainment, is required to purchase a 25-cent "thrift stamp," which is to remain his property, the amount paid for the stamp is not an "amount paid for admission" within the meaning of the Act.

**6648** (2) A certain amusement park company makes the purchase of two 15-cent tickets a requirement of admission to its park. These tickets are kept by the purchaser and can be used by him in payment of any charges for admission to attractions within the park. Within the meaning of the Act, the amount paid for these two tickets is not "paid for admission" to the amusement park but is "paid for admission" to the particular attractions for which they are used. (Unless the amusement park company is exempt from tax there will be a tax of 2 cents on each of these tickets—see Art. 1—to be paid at the time they are paid for. This tax applies even if such a ticket is good in payment of a nontaxable rental—for example, of a row-boat—as well as for a taxable admission to an attraction, because it can not be told for which it will be used. But if the park company sells two distinct kinds of 15-cent tickets, one kind good for a taxable admission to an attraction and the other not, then the 2 cents tax will apply only on the former kind, and if the person entering the park takes two tickets of the latter kind, then he will have no tax to pay on them.)

## D. Memberships

**6649** An amount paid to become regularly entitled to the privileges of a club or other organization, as member or otherwise, is not an "amount paid for admission," even though one of the privileges be the right to enter a clubhouse, club grounds, gymnasium, swimming pool, or the like. But where the chief or sole privilege of a so-called membership is a right of admission to certain particular performances or to some place on a definite number of occasions (as contrasted with a more or less unlimited right to enter a clubhouse or other place as many times as desired during a year or some other period), then the amount paid for such so-called membership is an "amount paid for admission" within the meaning of the Act. A tax is levied under



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certain circumstances on amounts paid as initiation fees or as dues or membership fees to certain classes of clubs or organizations, and also upon life members of such clubs, by section 801 of the Act. For this tax, called the "Tax on Dues," see Part 2 of these Regulations, under separate cover.

**6650 Examples.**—(1) Where one of the privileges of membership in a tennis club is the right of free admission to its grounds at all times, including the days on which the annual tennis tournament is in progress, neither the dues paid by such a member nor any part thereof can possibly be considered an "amount paid for admission" to such tennis tournament within the meaning of the Act.

**6651** (2) Where a so-called membership in a musical club costs \$10 a year and the chief or sole privilege of membership is the right to a ticket to each of five musical entertainments, the amount paid for this so-called membership is an "amount paid for admission" within the meaning of the Act.

**6652** (3) A certain athletic club has "swimming memberships," with annual dues of \$15, giving certain privileges, chief among which is the right to use the club swimming pool on any Tuesday, Thursday, or Saturday during the year. In this case neither the \$15 nor any part thereof can be considered as "paid for admission" within the meaning of the Act.

**E. Contributions**

**6653** Since the tax applies only to amounts necessarily paid for admission, it follows that contributions or donations voluntarily made, before or after admission to a place, are not taxable.

**6654 Examples.**—(1) Where everyone attending an exhibition given in a public park, freely open to the public, is requested during the course of the performance to make a contribution to the expenses of the exhibition and a tag is given to each contributor, an amount so contributed is not "paid for admission" within the meaning of the Act.

**6655** (2) Where oil paintings are exhibited without any entrance fee being charged, but at the close of the explanatory lecture a statement is made that contributions to pay the expenses of the exhibition will be cheerfully received, an amount so contributed is not "paid for admission" within the meaning of the Act.

**6656** (3) A certain baseball game is played on Sunday, in a State where amusements charging admissions are not allowed on that day, and, therefore, admission is made free to all, but, in order to make up as far as possible for the lack of admission fees, score cards are sold at an excessive price to such as will buy. An amount paid for such a score card is not "paid for admission" within the meaning of the Act. However, if the purchase of a score card at a fixed price is obligatory on all persons admitted, then amounts paid therefor are taxable, provided the price is in excess of 10 cents.

**CHAPTER TWO****Leases of Boxes or Seats**

**6657 Art. 6. Basis, rate, and computation of tax.**—In the case of a person having the permanent use or a lease for the use of a box or a seat in any opera house or other place of amusement (see Art. 7),

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the tax imposed by section 800 (a) (1) of the Act on "the amount paid for admission to any place" does not apply. Instead, the above provisions of the Act impose a tax on the right to the use of the box or seat equivalent to 10 per cent of the total amount that would be realized by the sale, at the established price, of the right to occupy a similar box or seat for each performance or exhibition during the period for which such box or seat is reserved for the lessee or holder. In other words, the tax is based not on the amount, if any, *actually paid* for the box or seat, but on the *amount that would be paid, at the established price, for admission and the use of similar accommodations*—not on the *actual use* of the box or seat, but on the *most extensive possible use*. Note that the rate of the tax here is 10 per cent and not "1 cent for each 10 cents or fraction thereof," as it is under section 800 (a) (1). In the case of a box, if there is no box of similar size, the tax for each performance or exhibition is to be computed by calculating on the above basis the tax payable on a single box seat in the same part of the house and multiplying that amount by the number of seats in the box. If there is no box occupying a similar position, the tax for each performance or exhibition is to be computed by calculating, on the above basis the tax payable on a single seat in the same part of the house and multiplying that amount by the number of seats in the box.

**6658** *Examples.*—(1) The season of a certain professional baseball club runs from April 15 to October 15. The club sells six-seat boxes under contracts which entitle the holders to occupy the same on all occasions when attractions are presented on the field between those dates. There are 70 games scheduled for the season, and the price of a six-seat box for a single game (including general admission of six persons to the grandstand) is \$10. In the case of the sale of a box under the above-mentioned contract, the tax to be collected from the holder at the time the contract is made is \$70 (70 times 10 per cent of \$10), and if extra attractions are presented on the field at any time during the period for which the box is held, additional tax equivalent to 10 per cent of the established price of a similar box must be collected on each such occasion, whether or not the box is occupied.

**6659** (2) The same club sells box seats under contracts which entitle the holders to occupy the same on all occasions when attractions are presented on the field between April 15 and October 15. The price of one of these seats for a single game (not including general admission to the grandstand) is 50 cents. In the case of the sale of a seat under the above-mentioned contract the tax to be collected at the time the contract is made is \$3.50 (5 cents for each of the 70 games scheduled), and if extra attractions are presented on the field at any time during the period for which the seat is held, additional tax equivalent to 10 per cent of the established price of a similar seat must be collected on each such occasion, whether or not the seat is occupied. The person who occupies the seat will, of course, be required to pay tax on the amounts paid from time to time for general admission to the grandstand, but this tax should be collected only when payments are made for general admission.

**6660** (3) The same club sells grand-stand seats under contracts which entitle the holders to occupy same on all occasions when attractions are presented on the field between April 15 and October 15. The price for one of these seats for a single game is 75 cents. In the case of the sale of a seat under the above-mentioned contract the tax to be collected at the time the contract is made is \$5.25 (7½ cents for each of the 70 games scheduled),



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and if extra attractions are presented on the field at any time during the period for which the seat is held, additional tax equivalent to 10 per cent of the established price of a similar seat must be collected, whether or not the seat is occupied.

**6661** (4) The owners of a certain opera house, in leasing it to an opera company, reserve for their own use the whole parterre tier of thirty-five 6-seat boxes, paying therefore annually the sum of \$70,000. These boxes are distributed among the various owners, \$2,000 a year being paid for an annual lease of each. There are no similar boxes in the house, but the established price of each seat in the box in the next tier, which is less desirable, is \$10 per seat. The number of performances during the season is fixed in advance at 100. Each lessee of such a box on paying the \$2,000 for the season must pay a tax of at least \$600 (100 times 10 per cent of 6 times \$10), to be paid over in turn to the opera company and the collector of internal revenue. This minimum figure for the tax is based on the established price of the box seats which are the most nearly similar, but which are less desirable. If extra attractions are presented at any time during the period for which the box is leased additional tax equivalent to 10 per cent of the established price of a similar box must be collected on each such occasion, whether or not the box is occupied.

**6662** **Art. 7. Meaning of "lease."**—This tax, as stated in Article 6, applies to cases where a person has the permanent use, or a lease for the use, of a box or seat in any opera house or other place of amusement. The only term here used that seems to need definition is the term "lease." The term "lease," as used in the foregoing provision of the law, means a continuous and exclusive right to use a particular box or seat for the term of the lease. The term "lease" does not include the right to use a box or seat merely on the occasion of regular performances given by a particular company, but the contract must give the holder of the box or seat the right to use the same whenever an attraction of any kind is presented in that place during the continuance of the lease. To constitute a lease of a box or seat within the meaning of these provisions of the Act a formal document of lease is not necessary.

**6663** **Examples.**—The following are examples of leases:

(1) A person owning a theater leases it to a producing company, reserving the right to the perpetual use, without charge, of a certain box.

**6664** (2) The owners of a certain opera house, in leasing it to an opera company, reserve for their own use the parterre tier of 35 boxes, paying annually \$70,000. These boxes are distributed among the various owners at \$2,000 for an annual lease.

**6665** (3) A corporation owning a theater gives the exclusive right to the use of a particular box for a year to all stockholders owning 1,000 shares, or to a particular seat to all stockholders owning 500 shares.

**6666** The following are examples of agreements which are not leases:

(4) A person arranges with a certain theater to reserve for his use a certain seat in the orchestra for every Monday night during the year. The theater is a vaudeville house which has two performances every day, the attractions running for a period of a week. Such a reservation, being for only a small proportion of the total number of performances, is not a lease within the meaning of the Act.

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**6667** (5) A certain grand-opera company which owns the building used by it has a regular season of 10 weeks of opera every winter, performances being given every night, including Sunday, and also on Saturday afternoons. On Sunday afternoons during the opera season concerts are given under the auspices of the company by various singers of the company. Outside of the opera season the auditorium in which the opera is held is rented by the opera company for various public meetings and theatrical attractions, etc., in order to secure additional income for the support of the opera company. A certain person reserves a box for every performance of the opera during the season, this reservation not including the Sunday concerts, nor, of course, the meetings and theatrical attractions outside of the opera season. This reservation does not constitute a "lease" within the meaning of the Act, because it does not give the holder of the box the right to use the same whenever an attraction of any kind is presented in the place. Any amounts paid for admission to this box under this reservation would, however, be taxable under section 800 (a) (1) unless exempted by the exemption provisions of the Act.

**6668** (6) A certain choral society gives a series of 10 concerts every winter. The concerts are given Sunday nights in a theatre, the use of which is rented for these occasions. The society sells subscription tickets which entitle the holder to the use of a particular seat for all 10 of the concerts. Such a subscription is not a "lease" within the meaning of the Act.

### CHAPTER THREE

#### Roof Gardens, Cabarets, or Similar Entertainments

**6669** **Art. 8. Basis, rate, and computation of tax.**—The tax imposed under 6505 the above provisions of the act applies to amounts paid for admission to any public performance for profit at any roof garden, cabaret, or similar entertainment, to which the charge for admission is wholly, or in part, included in the price paid for refreshment, service, or merchandise. If the admission charge, either in whole or in part, is so included, 20 per centum of the total amount paid for refreshment, service, or merchandise is deemed to be paid for admission.

**6670** If a fixed admission charge is imposed and it is fair and reasonable in comparison with charges made for similar performances or entertainments under different circumstances, such charge is taxable under paragraph (1) of section 800 of the Act and the tax imposed under paragraph (5) above would not apply to amounts paid for refreshment, service, or merchandise. If such admission charge is inadequate to cover the cost of the entertainment provided, 20 per cent of the charge for refreshment, service, or merchandise is taxable under paragraph (5). Where a specific, and apparently adequate, admission charge is made but the prices charged for refreshment, service, or merchandise during the entertainment are higher than at other times, the tax under paragraph (5) will apply to the amount paid for refreshment, etc., unless it is shown that the increase is due to other causes.

**6671** The fact that tax is paid on the admission charge proper under paragraph (1) will not operate to reduce or abate the tax due on the price paid for refreshment, service, or merchandise. Twenty per cent of the



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amount paid for the latter will be deemed to represent a charge for admission notwithstanding the payment of the specific but inadequate admission charge.

**6672** Charges commonly termed cover charges are not considered to be charges for admission within the provisions of paragraph (1). They represent charges for service and should be included in the total charge for refreshment, service, or merchandise.

**6673** The rate of this tax is different from that imposed on admissions proper under paragraph (1). However, it is not a flat 3 per cent tax, but is at the rate of  $1\frac{1}{2}$  cents for each 10 cents or fraction thereof of the proportion (20 per cent) of the price paid for refreshment, service, or merchandise, which represents the charge for admission. In practice it is found more convenient to compute the tax on the basis of  $1\frac{1}{2}$  cents for each 50 cents or fraction thereof of the total amount paid for refreshment, service, or merchandise in connection with public performances or entertainments at roof gardens, cabarets, etc. The process is simpler and the result is always the same.

**6674** *Examples.*—(1) A certain person invites four of his friends to attend a cabaret. No fixed charge is made for admission. His check for refreshments for the party amounts to \$15.87. As 50 cents is contained in \$15.87 thirty-one and a fraction times, the tax in this case is 48 cents (32 times  $1\frac{1}{2}$  cents).

**6675** (2) A certain person reserves a table for himself and three friends at a roof-garden entertainment and pays \$12 for the reservation, this being the regular price. This being a charge for admission, and apparently being adequate, there is no tax in this case under these provision of the Act, but a tax of \$1.20 is imposed by section 800 (a) (1) of the Act. The reservation of each seat at such a table must be evidenced by a ticket (see Article 30) and this ticket must comply with the provisions of Article 31.

**6676** (3) A certain restaurant conducts a cabaret in its main dining room every evening from 8 to 12 o'clock. In this case a person who takes dinner in that dining room and leaves the room before 8 o'clock and who therefore does not witness the cabaret at all, is not subject to any tax under these provisions of the Act.

**6677** (4) In this same restaurant there are other dining rooms so entirely separate from the main dining room that from them nothing that is going on in the main dining room can be either seen or heard. No cabaret performance or other entertainment is furnished in these other rooms. In this case no person dining in one of these other rooms, even during the time that the cabaret performance is going on in the main dining room, is subject to any tax under these provisions of the Act.

**6678** (5) A hotel, running a cabaret, requires every person entering to purchase a 50-cent food check. This check is later accepted as 50 cents in payment of the food and other refreshments consumed. A certain person purchases such a check for 50 cents and spends an evening at the cabaret. His bill at the end of the evening comes to \$8.33, and he pays it by handing in the check and paying \$7.83 in cash. The 50 cents so paid for this check is not "paid for admission" within the meaning of the Act. The tax in this case is based on the \$8.33 spent, and is 26 cents (17 times  $1\frac{1}{2}$  cents).

**6679** (6) A certain man goes to a cabaret where there is a general admission charge of 25 cents. The entertainment provided is very elaborate, and this is reflected in the price of the food. His bill for food comes to \$12.37. In this case there is an admission tax of 3 cents, due under Article

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1, on the 25 cents paid on admission. But as this amount is clearly inadequate there is also a tax of 38 cents (25 times  $1\frac{1}{2}$  cents), based on the amount paid for food.

**6680 Art. 9. Entertainments included.**—"Any public performance for profit at any roof garden, cabaret, or other similar entertainment" includes every public vaudeville or other performance or diversion in the way of acting, singing, declamation, or dancing, either with or without instrumental or other music, conducted for the profit of the management by professionals, amateurs, or patrons under the auspices of the management, in connection with the service of selling of food or other refreshment or merchandise at any room in any hotel, restaurant, hall, or other public place. Every form of entertainment so conducted is included, except instrumental music unaccompanied by any other form of entertainment.

**6681 Examples.**—(1) A proprietor of a dancing establishment provides for the serving of refreshments to his patrons. No charge is made for "admission" or for dancing. In this case the management is conducting an entertainment the admission charge to which is wholly included in the price paid for refreshments, and there will be a tax under these provisions of the Act.

**6682** (2) A certain hotel provides a space in its dining room for dancing and charges 50 cents admission to everyone entering the room. The prices charged for food are not increased to cover the cost of the entertainment furnished. In this case the amount paid for admission is not included in the price paid for refreshment but is this separate 50-cent charge. This charge, therefore, is taxable as an "amount paid for admission" under section 800 (a) (1) of the Act and the tax is 5 cents. (See Art. 1.)

**6683** (3) A certain other hotel maintains in its lobby a dancing floor surrounded by tables and serves refreshments to its patrons during the dancing hours. No charge is made for dancing. This is a case of a public performance for profit where the amount paid for admission is wholly included in the amount paid for refreshment and there will be a tax, therefore, under these provisions of the Act.

**6684** (4) A certain other hotel conducts in a room adjoining its dining room, during tea time and in the evening, an entertainment in the form of dancing for its patrons. No charge is made to those desiring to dance. This case, as the one mentioned in the preceding example, is a case where the amount paid for admission to a public performance for profit is wholly included in the amount paid for refreshment, and there will, therefore, be a tax under these provisions of the Act.

**6685** (5) A certain college alumni association gives a dinner to its members and invited guests, at a fixed charge per plate, at a certain hotel. Entertainers supplied by the hotel perform, and the diners themselves dance in an open space provided in the room. In this case, as the dinner is private, there is no tax, whether the cost of the cabaret performance is included in the charges per plate or is paid for in a lump sum by the alumni association.

**6686** (6) A certain chamber of commerce gives a dinner, in honor of a distinguished man, at \$5 a plate. Tickets are sold to anybody desiring to attend. Entertainment is furnished by performers supplied by the hotel where the dinner is served. In this case, as the entertainment is supplied by the hotel, it is clearly for profit, and as the affair is also public there is a tax under these provisions of the Act. This tax applies to each individual



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payment made for a dinner ticket and is 15 cents (10 times  $1\frac{1}{2}$  cents) in each case.

**6637** (7) A certain social club gives a dance at a hotel, charging \$2 a ticket to both men and women. During an intermission in the dancing a light buffet supper is served. In this case the \$2 is clearly paid for admission, and there is a tax of 20 cents under section 800 (a) (1) of the Act (see Art. 1).

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## CHAPTER FOUR

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### Taxes on Charges in Excess of Established Price

**6638** Art. 10. Scope and basis of taxes.—While two distinct taxes are imposed under the provisions of the Act quoted above—one on excess charges for tickets or cards of admission sold at places other than the ticket offices of the theaters, operas, or other places of amusement for which they are valid for admission, and the other on excess charges imposed by the proprietors, managers, or employees of such places—they are on a common basis and the scope of each is the same. Hence there are certain rules generally applicable to both. These will be found in this and in the succeeding article.

**6639** The tax on excess charges, whether imposed at the box office or by brokers, is of more limited application than the tax on admissions proper. The former attaches only to excess charges on tickets or cards of admission valid for admission to *theaters, operas, or other places of amusement*, whereas the tax on admissions attaches to amounts paid for admission to *any place* (see Art. 1). Thus, there are many cases where an admission tax is due which do not come within the scope of the excess-charge taxes. On the other hand, all cases to which the excess-charge taxes apply do not necessarily fall within the scope of Section (a) (1). As shown in Article 1, the full amount, including excess charges, paid for admission to the theater or person controlling the same is subject to the latter tax, which must be paid by the person paying for admission. However, excess charges paid to brokers or persons who do not control such admission are not regarded as payments for admission to any place and are not therefore subject to such tax. The taxes on charges in excess of the regular or established price (see Art. 11), whether the ticket or card of admission is sold at the box office or elsewhere, are to be paid by the person selling such ticket or card of admission. These taxes are therefore distinct from and in addition to the admissions' tax.

**6690** Art. 11. Regular or established price defined.—By the "regular or established price" of admission is meant the full-rate price fixed by the person controlling such price at the beginning of the first sale or distribution of tickets or cards valid on that occasion as the price to be charged for that particular class of admissions. The person in control has, of course, the power to fix the price to be actually charged for admission. He has, therefore, the power to determine the established or regular price. But as an established price is a matter of substance, not of name, the mere fact that he calls a price an "established price" does not make it such. Nor are the prices he charges for particular admissions necessarily the established or

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regular prices of such admissions. If he arbitrarily sets different prices on admissions, under similar circumstances, to accommodations in all substantial respects similar, these different prices will not be the established or regular prices of the respective admissions for which they are charged, but the lowest price among them will be the established or regular price of all such admissions. The established or regular price of admission can, of course, be uniform or can vary in accordance with the accommodations to which admission is granted, increasing from the price of a mere general admission through the various grades of accommodations to the best accommodations. Any scale of prices, adopted in good faith, in which the prices increase regularly with the increase of accommodation, will be considered to show the true established or regular prices of admission to such respective accommodations; but the variation of prices must be regular and based on a real difference of accommodation and not merely arbitrary. The established price of an admission need not be the same for different attractions or even for different performances of the same attraction; but when tickets have once been put on sale for a particular performance or attraction the price of admission for every accommodation at that performance or attraction has been established. Established prices of admission once so adopted are not affected by the mere sale of admissions at prices different from the ones so established. Nor can established prices once so adopted for any occasion be increased for that occasion. If sold at a higher price the excess charge will be taxable. Prices once established or adopted may be reduced, but in such case liability to excess-charge taxes with respect to all admissions sold at the original established prices can be avoided only by complying with the following conditions:

**6691** (1) Any reduction of established price must include all admissions of that particular established price and must grant an equal reduction in the case of each; (2) such reduction must not result in setting a lower price on admission to certain accommodations than is charged on that occasion under similar circumstances for admission to accommodations which are in all substantial respects similar; (3) public notice must be promptly given of the reduction and of the fact that every person having paid for admission at the former established price can secure a refund at any reasonable time of the amount he paid in excess of the new established price; and (4) such refunds must be actually made promptly on request.

**6692** The foregoing provisions of this article relate to single admissions, but they also control in the case of season tickets and subscriptions. A season ticket may be defined as a contract which entitles the holder to admission at all times during a season, or at regular specified times during the entire season. It may include admission to all performances for the season or at specified nights or performances during the entire season. A subscription ticket is one which is issued to a person who subscribes a sum of money to the expense of an entertainment or who agrees to bear a portion of the expense thereof when the amount is ascertained. The established price for such ticket or subscription is the amount fixed (at the beginning of the sale of such ticket or subscription by the person controlling the price) as the price to be charged therefor.

**6693** The price (exclusive of the tax imposed under paragraph (1) of section 800 (a)) at which every ticket or card of admission is sold must be conspicuously and indelibly printed, stamped, or written on the portion thereof which is to be taken up by the management of the theater, opera, or other place of amusement for which it is valid (see Art. 31). And if sold



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at a place other than the ticket office of the theater, opera, or other place of amusement the name of the vendor must also be shown (see Art. 31).

## A—BOX-OFFICE SALES

**6694** Art. 12. Rate and computation of tax.—Where a proprietor, manager, 6503 or employee of any opera house, theater, or other place of amusement sells or disposes of any ticket or card of admission for an amount in excess of the regular or established price or charge therefor, as outlined in Article 11, the excess portion of the price for which it is so sold or disposed is subject to the tax of 50 per cent imposed under paragraph (3) of section 800 of the Act. The rate of the tax is always 50 per cent regardless of the amount by which the selling price exceeds the regular or established price. This tax is to be paid by the person selling or disposing of the ticket, and, as shown in Article 10, is distinct from, and in addition to, the admissions tax (Art. 1), which is to be paid by the person to whom the ticket is sold.

**6695** The fact that this tax is on a percentage basis makes possible a tax involving a fraction of a cent. As the tax is based on each excess charge imposed, several items of tax each involving a fractional part of a cent may be due with each monthly return. These several fractions should be preserved or included in computing the total tax due with any given return. If the total thus obtained involves a fraction of a cent equal to one-half cent or more, it shall be increased to 1 cent; otherwise it shall be disregarded.

**6696** *Examples.*—(1) The established price of the seats in the orchestra of a certain theater is \$2. These seats are put on sale three weeks in advance. The running attraction being very popular, the management decides one Friday night to increase, by 25 cents, the price of all orchestra seats for the next week still unsold. In this case, as an increase so made can not affect the established price, that price remains \$2. Therefore, a tax of  $12\frac{1}{2}$  cents is due from the theater in the case of each ticket for one of these seats sold for \$2.25, in addition to the 23 cents tax payable by the purchaser of each ticket. In making its return at the end of the month the theater should add together all of these  $12\frac{1}{2}$ -cent taxes, and if the total sum ends in a half cent (as, for example, \$227.37 $\frac{1}{2}$ ), then the tax to be paid, complying with section 1306 of the Act, will be one-half cent greater than this amount (in other words, \$227.38).

**6697** (2) If, in the case outlined in the preceding example, the attraction had proven unpopular, resulting in a reduction of the established price to \$1.50, the management would be liable to a tax of 25 cents on each ticket or card of admission sold at the original established price of \$2, unless the conditions enumerated in Article 11 were complied with.

## B—BROKER'S SALES

**6698** Art. 13. Rate and computation of tax.—The rate of the excess-charge 6502 tax in the case of cards or tickets of admission sold at news stands, hotels, and places other than the ticket offices of the theaters, operas, or other places of amusement, unlike that imposed on the proprietors, managers, or employees of opera houses, theaters, or other places of amusement (see Art. 12), depends on the amount by which the selling price exceeds the regular or established price. If the excess charge is 50 cents or less, the rate of tax is 5 per cent of such excess charge; if more than 50 cents, the rate is 50 per cent of the excess charge.

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**6699** In determining the amount of the excess charge, the amount of any tax imposed under paragraph (1) of section 800 (a) is taken into consideration. That is to say, such tax is always added to the regular or established price and the sum so obtained is subtracted from the selling price. The remainder represents the excess charge, and the 5 per cent or 50 per cent tax applies according as the charge amounts to 50 cents or less or exceeds that amount. Where the excess charge is more than 50 cents, the *whole* amount of such excess charge is taxable at the 50 per cent rate. Thus, by way of illustration, if a ticket broker sells for \$2.50 a ticket or card of admission the regular or established price of which is \$2, the excess charge is not 50 cents, but 30 cents. This is determined in the following manner:

Established price.....	\$2.00
Admission tax thereon.....	.20
<b>Total.....</b>	<b>2.20</b>
Sale price.....	\$2.50
Difference representing taxable excess charge.....	.30
Tax due (5 per cent rate).....	.015

**6700** Had the broker sold this ticket for \$3, his tax liability would have been as shown below:

Established price.....	\$2.00
Admission tax thereon.....	.20
<b>Total.....</b>	<b>2.20</b>
Sale price.....	\$3.00
Difference, representing taxable excess charge.....	.80
Tax due (50 per cent rate).....	.40

However, should the broker in each of the preceding examples reimburse himself by collecting from his customer the amount of the admission tax imposed under section 800 (a) (1), the total sale price of each ticket would then be \$2.70 and \$3.20, respectively, and the tax on the excess charges of \$0.50 and \$1 would be \$0.025 and \$0.50, respectively.

**6701** No admission tax is due or collectible by the broker in this connection, since such tax has already been paid to and collected by the theater or person controlling the admission.

**6702** The tax on excess charges applies to tickets or cards of admission to theaters, operas, or other places of amusement "sold at news stands, hotels, and places other than the ticket offices of such theaters, operas, or other places of amusement" at prices in excess of the regular or established prices at such ticket offices. Therefore, any person who in his individual capacity and not as an employee or representative of a theater, opera, or other place of amusement, sells or disposes of tickets or cards of admission at prices in excess of the regular or established prices at the ticket offices of such theater, opera, or other place of amusement is liable to the payment of this tax. This liability attaches whether or not the selling or disposing of such tickets or cards of admission is the principal business or occupation of such person.

**6703** As this is a percentage tax, like that imposed on excess charges imposed by theaters, operas, or other places of amusement (see Art. 12), individual transactions will frequently result in a tax involving a fraction of a cent. These fractional parts of cents should be preserved in computing the monthly total of tax due. If the grand monthly total involves a fraction of a cent equal to one-half cent or more, it shall be increased to 1 cent; otherwise it shall be disregarded.



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**6704** It should be particularly noted that this tax is based on the amount charged in excess of the *established price*, not in excess of the *price the broker pays*. The fact that the broker himself may have paid the theater, opera, or other place of amusement more than the established price for a ticket or card of admission sold or disposed of by him does not affect the tax to be paid by the broker on an excess charge made by him. In other words, if a theater makes an excess charge to a broker, and the broker in turn makes an equal or greater excess charge to his customer, then both the theater and the broker must pay an excess-charge tax on the amount of the excess charge over the established price.

**6705** Where a ticket is sold by a theater to a broker at the established price and it thereafter passes through the hands of one or more brokers before being sold to a user, each broker who sells the ticket for an amount in excess of the established price must pay the tax on the whole amount by which his selling price exceeds the amount of the established price of the ticket at the ticket office of the theater, opera, or other place of amusement plus the tax imposed on such established price under paragraph (1) of section 800 (a). For information as to the manner in which returns shall be made and the tax paid over by brokers, and as to how they may reimburse themselves or take credit for taxes—both admission and excess-charge—paid by them, see Article 36.

**6706** *Examples.*—(1) A certain ticket broker purchases from a theater a block of tickets for seats in the orchestra, the established price of admission to which is \$2, and resells them at an excess charge of 50 cents per ticket. The taxes to be collected and paid by the theater and broker in this case are as follows:

## Theater

<i>Receives from broker</i>		<i>Must pay to collector</i>	
Established price.....	\$2.00	which it retains.	
Admission tax.....	.20	which it must pay to collector.....	\$0.20
Total.....	2.20	Total.....	0.20

## Broker

<i>Receives from customer</i>		<i>Must pay to collector</i>	
Established price.....	\$2.00	which he retains.	
Additional charge.....	.20	which he retains as refund of admission tax paid to theater.	
Excess charge.....	.50	of which he must pay as tax to collector.....	\$0.025
Total.....	2.70	Total.....	.025

**6707** (2) In the preceding example had the theater charged the broker \$2.25 for the tickets, the established price of which was \$2, and the broker in turn had increased the excess charge by 25 cents, the taxes to be collected by the theater and broker would have been as follows:

## Theater

<i>Receives from broker</i>		<i>Must pay to collector</i>	
Established price.....	\$2.00	which it retains.	
Excess charge.....	.25	of which it must pay as tax to collector.....	\$0.125
Admission tax.....	.23	which it must pay to collector.....	.23
Total.....	2.48	Total.....	.355

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## Broker

<i>Receives from customer</i>	<i>Must pay to collector</i>
Established price.....	\$2.00 which he retains.
Additional charge.....	.23 which he retains as refund of admission tax paid to theater.
Excess charge.....	.50 of which he must pay as tax to collector.....
	\$0.025
Total.....	2.73
	Total.....

**6708** (3) Again, had the theater charged the broker \$2.50 for the \$2 seats and the broker in reselling them had increased the excess charge by \$1.25, the tax to be collected and paid by each would have been as follows:

## Theater

<i>Receives from broker</i>	<i>Must pay to collector</i>
Established price.....	\$2.00 which it retains.
Excess charge.....	.50 of which it must pay as tax to collector.....
Admission tax.....	.25 which it must pay to collector.....
	.25
Total.....	2.75
	Total.....

## Broker

<i>Receives from customer</i>	<i>Must pay to collector</i>
Established price.....	\$2.00 which he retains.
Additional charge.....	.25 which he retains as refund of admission tax paid to theater.
Excess charge.....	1.75 of which he must pay as tax to collector.....
	\$0.875
Total.....	4.00
	Total.....

**6709** (4) A ticket broker purchases from a theater a block of tickets for seats, the established price of admission to which is \$2, and resells them at an excess charge of 50 cents per ticket. He has an arrangement with the theater, however, by which half this excess charge so received by him is to be paid to the theater as a rebate. In this case this rebate of 25 cents received by the theater is in fact an excess charge made by it. The theater, therefore, will be subject to a tax of 50 per cent of that amount (12½ cents) as a tax on an excess charge. The final result as to taxes, etc., will be the same, therefore, as that shown under example 2 above.

**6710** (5) A theater-ticket agency procures tickets from various theaters with the privilege of returning an hour before the performance starts all tickets for that performance then unsold. Such agency charges for each ticket sold 10 cents more than the sum of the established price and the amount paid to the theater as an admission tax, and terms this 10-cent charge a "service charge." In this case it is clear that the 10-cent advance is in fact an excess charge and that the agency is liable for an excess-charge tax of ½ cent.

## CHAPTER FIVE

## Exemptions

**6711** **Art. 14. Taxes to which exemption applies.**—Two classes of taxes are imposed by section 800 (a): (1) A tax on admissions proper, which is to be paid by the person paying for admission (see Chapter



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One), and (2) a tax on charges in excess of the regular or established price, which is to be paid by the person selling or disposing of tickets or cards of admission at prices in excess of the regular or established price thereof (see Chapter Four).

**6712** One of the conditions on which the exemption herein provided, in the case of organizations, societies, and persons coming under classification (1), (A), (B), and (C), is predicated is that *all the proceeds* of the admissions must inure *exclusively* to the benefit of such organizations, societies, or persons.

**6713** This exemption was clearly intended to apply to both classes of taxes.

In cases where both taxes are applicable it frequently happens that the proceeds of the admissions and the proceeds of the excess charges will inure to the benefit of different persons; that is, an organization entitled to exemption may receive all the proceeds of the admission proper, while the proceeds of the excess charges may accrue to the benefit of an organization or persons not entitled to exemption.

**6714** In such cases it is necessary, in order to put into effect the manifest intent of the law, to construe this exemption provision as applying separately to each of the taxes. So, where *all the proceeds* of admissions proper inure exclusively to the benefit of organizations or persons coming within this provision of the Act the exemption will apply with respect to such admissions, even though the proceeds of the excess charges go to the benefit of non-exempt organizations or individuals. Conversely, if *all the proceeds* of the excess charges inure exclusively to the benefit of exempt organizations or persons, such excess charges will be exempt from tax, although amounts paid for the admissions proper are taxable under paragraph (1) of section 800(a).

**6715** The term "all the proceeds" is held to mean all the proceeds of the admissions and excess charges, as the case may be, after the payment of reasonable expenses. These expenses need not necessarily be on a fixed or guaranty basis, but may also be based upon a certain percentage of the receipts or the number of admissions sold, provided the contingent feature of the contract is reasonable and operates *solely* for the benefit of an exempt organization or person. Thus, where services, property, rentals, and other items of expense are engaged on a percentage basis, or the amounts to be paid therefor are dependent in whole or in part upon the amounts received from the sale of admissions or from excess charges, the right to exemption is not necessarily defeated, unless the net proceeds after the deduction of all reasonable expenses do not inure exclusively to the benefit of an organization or person entitled to exemption under section 800(b) of the Act. Where, however, by reason of a contingent agreement as above described, the partial guaranty plus the percentage of the receipts equal an amount greater than the regular fixed price charged for the talent, then the exemption from admissions tax is defeated for the net proceeds of admissions do not inure exclusively to an exempt organization or person unless, of course, both the organization furnishing the talent and the organization giving the entertainment qualify as such.

**6716** The essential qualifications of exempt organizations and persons are discussed in Arts. 15-28, *infra*. As to the procedure to be followed in securing exemption, see Art. 29.

**6717** *Examples.*—(1) A woman's auxiliary of a charitable hospital in a large city gives an entertainment for the benefit of the hospital. The

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established price of admission to all seats is \$3. This organization, which qualifies as exempt under section 800(b), is largely made up of society women, and seats are very much in demand. A certain ticket broker secures a large number of them and sells them at \$4 apiece. In this case the admissions proper are exempt from the Taxes on Admissions, in spite of the fact that the proceeds of the excess charges made by the broker go into his pocket. Therefore no admission tax need be charged to the broker or anyone else on the original sale of the tickets. However, he must pay an excess-charge tax of 50 cents on each ticket sold.

**6718** (2) A certain society circus, the established price of admission to which is \$5, is given for the benefit of the Salvation Army. Many of the tickets to this circus are auctioned off by the management at a large advance in price and the proceeds of the auction also given the Salvation Army. In this case no taxes are imposed on either the admissions proper or the excess charges.

**6719** (3) A certain charitable organization, which qualifies as exempt under section 800(b), purchases from the box office of a theater, in the regular way and at the established price, fifty \$2 tickets. It sells them all for \$5 apiece (exclusive of any admission tax) for the benefit of the charity. In this case an admission tax of 20 cents, based on the \$2 paid to the theater, must be paid on each ticket at the time of its purchase. (Of course, it can if it desires collect 20 cents more to cover the admission tax it paid to the theater.) On the other hand, no excess-charge tax is due from the charitable organization on account of the sale of these tickets at an excess charge.

**6720** **Art. 15. Basis of exemption.**—It is to be noted that the basis on which exemption rests in the case of organizations and persons coming within classification or subdivision (1) of this provision of the Act differs from that applicable in the case of agricultural fairs, which are covered by classification or subdivision (2). As shown in the preceding Art. (14), in the case of the first class of organizations or persons the right to exemption depends on whether *all the proceeds* of the admissions, or excess charges, as the case may be, inure exclusively to the benefit of such organizations or persons. Aside from this condition, it is only necessary, in order to secure exemption, to establish the character of the beneficiary organizations or persons. It is not necessary that the organization or persons selling the admissions, or controlling the affair to which the admissions are sold, be entitled to exemption so long as all the proceeds of such admissions inure to the benefit of an organization or person that qualifies as exempt. In other words, the character of the organization or person receiving all the proceeds of the admissions or excess charges, and not the character of the organization or persons selling the admissions, determines whether or not exemption applies. Admissions to *any place*, regardless of the nature of the attraction or affair, are exempt if all the proceeds, as defined in Art. 14, inure exclusively to the benefit of an organization or a person or persons included in this provision of the Act.

**6721** On the other hand, in the case of agricultural fairs, exemption applies only in respect to admissions to agricultural fairs as such, or to exhibits, entertainments, or other pay features conducted as part of such fairs. Admissions to any other place would not be exempt even though all the proceeds thereof inured exclusively to the benefit of an agricultural fair association.



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**6722** On account of the different bases on which exemption is funded, as herein outlined, the two classes of cases will be dealt with separately in the following articles. First, with respect to—

## ORGANIZATIONS OTHER THAN AGRICULTURAL FAIRS

**6723** **Art. 16. Necessary character of organization.**—For an organization to be considered a religious, education, or charitable institution, society, or organization within the meaning of the Act: (1) It must have a definite organization, with officers, directors, or trustees, and the usual essential features (incorporation not being essential) of an association of its class; (2) it must have a purpose which as put into practice is religious, educational, or charitable; and (3) its funds must be used solely in furtherance of such purpose, none of them being paid or otherwise distributed to any of its members except as charity or as reasonable compensation for services actually rendered.

**6724** For an organization to be considered a “society for the prevention of cruelty to children or animals” it must comply with conditions (1) and (3) of the preceding sentence, and also with condition (2), except that in its case the purpose to be expressed and put into practice must be the specific purpose of the prevention of cruelty to children or animals, or both, and not one of the three general purposes mentioned in condition (2).

**6725** Societies or organizations conducting symphony orchestras must comply with conditions (1) and (3). Moreover, before exemption can be extended to such a society or organization it must affirmatively show (a) that the conducting of a symphony orchestra is its sole purpose, and (b) that it receives substantial support from voluntary contributions.

**6726** Societies or organizations conducted for the purpose of improving any city, town, village, or other municipality must likewise comply with conditions (1) and (3), and must furthermore show that this is their sole purpose. The same rule applies to societies or organizations conducted for the purpose of maintaining cooperative or community center moving-picture theaters.

**6727** It should be carefully noted that, while exemption is granted only to organizations operating on a nonprofit basis, the mere fact that an organization is not organized or operated for gain or profit does not afford a basis for exemption. To be entitled to such exemption the organization must comply with the other conditions herein outlined. There is no requirement, expressed or implied, that an institution, society, or organization to be included within these exemption provisions must be organized or operating in the United States.

**6728** As to the procedure to be followed in securing exemption, see Art. 29.

**6729** **Art. 17. Religious organizations.**—Admissions, or excess charges, all the proceeds of which (after payment of reasonable expenses) inure exclusively to the benefit of religious institutions, societies, or organizations are exempt from tax. Churches and theological seminaries are the commonest cases of religious institutions. Missions and missionary societies also clearly fall within the exemption. Church societies are religious societies only if they share in the religious purpose of the church. Nation-wide organizations which are not church organizations but which have as their purpose the furtherance of religion are religious societies.

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**6730** *Examples.*—(1) The members of a certain church form a club for social and athletic purposes and hold their meetings in one of the church buildings. In order to raise money for club purposes they give dances and other entertainments. In this case, as the club is not formed or operated for religious purposes, but purely for social and athletic purposes, admission to these dances and entertainments are not exempt on the ground that the club is a religious organization.

**6731** (2) A certain church organizes a men's club to increase community feeling, and while the meetings are opened with prayer the club itself has no religious purpose and members of all religions and denominations are entitled to membership. This club, though holding its meetings in the church building itself, is not a religious organization within the meaning of the Act.

**6732** (3) A certain church organizes a men's Bible class, which meets every Sunday to study the Bible. This class holds an entertainment in order to raise money to buy Bibles and maps to be used in its work. Admissions to the entertainment are exempt from tax, for the class is a religious organization within the meaning of the Act.

**6733** (4) A club organized for the sole purpose of raising money to support a missionary is a religious organization within the meaning of the Act.

**6734** (5) A Young Men's Christian Association or Young Men's Hebrew Association is a religious organization within the meaning of the Act.

**6735** **Art. 18. Education organizations.**—Admissions, or excess charges, all the proceeds of which (after payment of reasonable expenses) inure exclusively to the benefit of institutions, societies, or organizations that are educational within the meaning of the Act as stated in this article and Art. 16, are exempt from tax. Schools, colleges, and universities, qualifying under Art. 16, fall within this exemption. The same is true of any organization whose dominant purpose is the education of its members or of other persons. Education here includes musical education. It also includes physical education, so any organization, devoted to physical education pure and simple, and complying with Art. 16, is educational within the meaning of the Act; but if the element of sport enters into its purposes, then it can not be considered exempt as an educational society or organization. Admissions, or excess charges, are not exempt merely because the proceeds are to be used for an educational purpose—the character of the organization to which they will inure is the test, not the purpose merely. Admissions, or excess charges, to contests or entertainments are exempt from tax where the proceeds are to be expended for athletic or other school, college, or university purposes by or under the direct supervision of the authorities of a school, college, or university which qualifies under Art. 16.

**6736** *Examples.*—(1) Admissions charged to a football game where the net proceeds are expended for athletic purposes under the direct supervision of the faculty of a college (neither organized nor operated for profit) are exempt from tax.

**6737** (2) Admissions to a college baseball game the proceeds of which inure to a students' athletic association to be spent in their discretion, without any college supervision, for the support of athletic teams or other interests of the members of the association, are taxable.



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- 6738** (3) A private school run for the profit of its proprietors (in other words, not qualifying under condition (3) of Art. 16) is not an educational institution, society, or organization within the meaning of the Act.
- 6739** (4) A music-festival association is organized and operates in a city with the purpose of educating the community up to good music and cultivating its musical taste. It also complies with conditions (1) and (3) of Art. 16. This association is an educational organization within the meaning of the Act. Admissions, therefore, to a music festival given by it are exempt from tax.
- 6740** (5) Where an association maintaining a zoological park is a corporation not for profit, whose purpose is to exhibit animals and give instruction in connection therewith, admissions to the park are exempt from tax because they inure to an educational institution.
- 6741** (6) Where the pupils in a certain room in a certain school form an organization for pleasure and social purposes and give an entertainment, the proceeds of which are to be used to give a picnic, the admissions thereto are taxable, for such organization is not educational.
- 6742** (7) Admissions to an entertainment given by a college fraternity for its benefit are taxable, for such a fraternity is not educational within the meaning of the Act.
- 6743** (8) Admissions charged to an illustrated lecture, educational in character, where the net proceeds go to the lecturer, are taxable.
- 6744** (9) A Young Men's Christian Association or Young Men's Hebrew Association is an educational organization within the meaning of the Act.
- 6745** (10) The activities of a social settlement, incorporated "not for profit," consist chiefly of classes in English, mathematics, modern languages, manual training, sewing, cooking, etc. Entertainments are held from time to time to raise money to help carry on these activities. Admissions to such entertainments are exempt from tax, for the settlement is clearly educational within the meaning of the Act.
- 6746** (11) A certain class in a county high school gives an entertainment of which the net proceeds are to be used to buy a victrola to be given to the school. In this case, if the principal of the school has joined, on behalf of the school, in an affidavit for exemption (see Art. 29), a certificate of exemption can be secured which makes the admissions exempt from tax. If, however, the victrola was to become the property of the class, to be removed from the school on its graduation, the exemption would not apply.
- 6747** (12) The Boy Scouts and Girl Scouts of America are educational organizations within the meaning of the Act.
- 6748** (13) A football game played between a college team and a team operating for profit, under an agreement whereby the receipts are to be divided on a percentage basis. The college team turns its share into the college treasury, while the opposing team's share is only sufficient to pay its actual expenses. Admissions to the game are taxable, since all the proceeds (see Art. 14) do not inure to the benefit of the college.

**6749** **Art. 19. Charitable organizations.**—Admissions, or excess charges, all the proceeds of which inure exclusively to the benefit of charitable institutions, societies, or organizations, complying with the conditions outlined in Art. 16, are exempt from tax. Any organization the primary purpose of which is benevolent or charitable comes within the meaning of the

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term "charitable" as used in the Act. An organization is not precluded from exemption merely because its gratuities are limited to its members and/or their dependents.

**6750** *Examples.*—(1) Admissions to an entertainment given by a fraternal organization, the net proceeds of which inure to the exclusive use of a home for indigent and aged members and their dependents or a similar institution, not operated for profit, are exempt from tax.

**6751** (2) An organization not qualifying as exempt under the provisions of the Act gives an entertainment and distributes the proceeds to certain deserving poor people whose names it has obtained from the Associated Charities. In this case the admissions are taxable, for the proceeds do not inure to a charitable organization. If, however, the net proceeds had been turned over to the Associated Charities to be distributed by it in aid of the poor, the admissions would have been exempt from tax.

**6752** (3) An association organized and operated for the relief of war-stricken people abroad, and also complying with conditions (1) and (3) of Art. 16 gives an entertainment and uses the proceeds in furtherance of its work. Admissions to this entertainment are exempt from tax, for it is a charitable organization within the meaning of the Act.

**6753** (4) A relief association, organized by the police of a certain city for the sole purpose of providing a fund for the relief of dependents of deceased policemen, gives a baseball game and turns the proceeds into its treasury. Admissions to the game are exempt from tax.

**6754** **Art. 20. The American Legion.**—Admissions or excess charges, all the proceeds of which inure exclusively to the benefit of any post of the American Legion, or any women's auxiliary unit of the American Legion, are not taxable.

**6755** **Art. 21. Symphony orchestra organizations.**—Admissions, or excess charges, all the proceeds of which inure exclusively to the benefit of an organization conducted for the sole purpose of maintaining a symphony orchestra and receiving substantial support from voluntary contributions—if no part of the net earnings thereof inures to the benefit of any private stockholder or individual—are exempt from tax.

**6756** The name by which an organized group of musicians is called is not the test of whether or not such group is a symphony orchestra. To be a symphony orchestra it must have a personnel of sufficient size, quality, and ability to capably render symphonies, and must make them a regular part of its program. Bands and ordinary orchestras are clearly not included in the exemption.

**6757** **Art. 22. Persons in the military or naval service.**—Admissions, or excess charges, all the proceeds of which (after payment of reasonable expenses) inure exclusively to the benefit of a person or persons in the military or naval forces of the United States, are exempt from tax. Soldiers and sailors, of course, constitute the chief classes of persons covered by this exemption, but it also includes nurses, male or female, and other members of such military or naval forces not ordinarily included within the term "soldiers and sailors." It does not include persons formerly but no longer members of such forces, whether in uniform or not, except as provided in Art. 23, nor does it include members of the National Guard of a State, even



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though the National Guard Organization is recognized by the Federal Government under the Act approved June 4, 1920, entitled "An Act to amend an Act entitled 'An Act for making further and more effectual provision for the national defense, and for other purposes,' approved June 3, 1916, and to establish military justice," though it does include persons in the United States Military or Naval Reserve. It applies equally whether the proceeds inure exclusively to the benefit of a single person or of many persons if they are in the active service. An individual in the military or naval reserve engaged in the business of selling admissions for gain or profit would not be entitled to exemption.

**6758 Art. 23. Persons formerly in the military or naval service.**—Admissions, or excess charges, all the proceeds of which inure exclusively to the benefit of persons, individually or collectively, who have served in the military or naval forces of the United States, and *are in need*, are exempt from tax. This exemption applies to persons who have at any time served in any of the arms or branches of service specified in the preceding Article, and who are in need. The phrase "are in need" is held to mean in need of necessities of life which such persons themselves are unable to provide by reason of physical or mental disability or other legitimate cause beyond their control. It includes necessities for the personal use of ex-service men or women and also necessities for members of their families who are legally dependent on them for support.

**6759** It is not necessary that the needy condition should have been occasioned by or arisen out of their military or naval service, or to be in any way connected with or related to such service. Whether a person, or group of persons, is in need is a question of fact, and when exemption is claimed by or on behalf of persons coming within this class it is incumbent on the claimant to show the existence of the need.

**6760 Art. 24. Municipal improvement societies.**—Exemption is accorded to admissions, and excess charges, all the proceeds of which inure exclusively to the benefit of societies or organizations conducted for the sole purpose of improving any city, town, village, or other municipality—if no part of the net earnings thereof inures to the benefit of any private stockholder or individual.

**6761** It is to be noted that the exemption applies only to societies or organizations the *sole* purpose of which is the improvement of cities, towns, villages, or other municipalities. It would not, therefore, include a municipal government itself (see Art. 26), for, while in a broad sense it may be said that such governments are designed for the improving of the communities they serve, the scope of their activities is wider than that of the organizations contemplated by this provision of the Act.

**6762** By "improving" is obviously meant any work or undertaking looking to the introduction, inauguration, or betterment of any facility, agency, or other service or thing designed or maintained for the common use and benefit of all the people of the community. Organizations the purpose of which is to improve and beautify public roads, streets, parks, and other public utilities or services, to improve educational and health conditions, to raise funds for the acquisition and care of apparatus for a volunteer fire company, and the like, would come within the exemption.

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**6763** **Art. 25. Cooperative or community-center moving-picture theater organizations.**—No tax applies to admissions or excess charges all the proceeds of which inure exclusively to the benefit of societies or organizations conducted for the sole purpose of maintaining cooperative or community-center moving-picture theaters—if no part of the net earnings thereof inures to the benefit of any private stockholder or individual.

**6764** The exemption covers not only admissions to cooperative or community-center moving-picture theaters maintained by such societies or organizations, but also to any admissions all the proceeds of which inure exclusively to the benefit of such organizations. This exemption does not include community-center organizations, even though they maintain cooperative or community-center moving-picture theaters, if their purposes and activities extend beyond this one object.

**6765** **Art. 26. Admissions by or for the benefit of Federal, State, or Municipal governments.**—The fact that the authority charging admissions or receiving the proceeds thereof is the United States or an agency thereof, or a State or Territory or political subdivision thereof, such as a county, city, town, or other municipality, does not make such admissions exempt. The Act specifically provides that the taxes on admission (Chapter One) shall be paid by the person paying for admission. It is not, therefore, a tax on the person or authority selling the admissions or receiving the proceeds thereof.

**AGRICULTURAL FAIRS**

**6766** **Art. 27. Basis of exemption.**—The tax on charges in excess of the regular or established price of admission has no application in the case of admissions to agricultural fairs (see Art. 15). Therefore, it is only necessary to consider under this head the tax on admissions imposed by paragraph (1) of section 800 (a).

**6767** The exemption from this tax in this instance depends (1) on the nature of the place or exhibit to which admissions are sold, (2) on whether the fair or exhibit is conducted for financial profit, and (3), in the case of any exhibit, entertainment, or other pay feature, the disposition made of the proceeds therefrom.

**6768** **Art. 28. Fairs and exhibits included.**—The exemption includes not only agricultural fairs as such, but also “any exhibit, entertainment, or other pay feature” conducted by an association conducting an agricultural fair, and *as part of* such fair.

**6769** The term “agricultural fairs” includes, in general, all exhibitions of farm produce, live stock, poultry, flowers, or the like, held for the promotion or advancement of agriculture (which includes horticulture). It includes within its meaning any exhibition of animals, of a species whose chief utility is in connection with agriculture, held by an association organized to improve that species of animal and to disseminate knowledge concerning its breeding.

**6770** No limitation or restriction is imposed with respect to the character or nature of the exhibits, entertainments, or other pay features, admissions to which are exempted. It is only necessary that such exhibit, entertainment, or other pay feature (a) be conducted by the association conducting the agricultural fair, (b) as a part of such an agricultural fair,



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and (c) that the proceeds therefrom be used exclusively for the maintenance and operation of such agricultural fairs. If these conditions are satisfied, it is immaterial whether or not the exhibit, entertainment, or other pay feature is designed to promote or advance agriculture or its allied industries. The exemption does not extend to admissions to exhibits, or features operated by concessionaires in connection with agricultural fairs, nor to admission to any place other than an agricultural fair or an exhibit or feature held in conjunction with such a fair, even though all the proceeds inure exclusively to the benefit of an agricultural fair association.

**6771** *Examples.*—(1) A retail grocers' association gives a food show lasting a week in a large hall in a city. The raw food products, the processes of manufacture, the finished food products, and the foods prepared for the table are all exhibited. Such an exhibition is not an agricultural fair within the meaning of the Act.

**6772** (2) A horse show held in a large city, where most of the horses exhibited are fancy riding and driving horses and the show is largely a social event, is not an agricultural fair within the meaning of the Act.

**6773** (3) A horse fair held by a society organized to improve the quality of farm animals, the animals exhibited being chiefly of that class, is an agricultural fair within the meaning of the Act.

**6774** (4) A certain dog fanciers' association gives a dog show in a city. A large majority of the dogs exhibited belong to fancy and house varieties. Such a show is not an agricultural fair within the meaning of the Act.

**6775** (5) A poultry fanciers' association gives a poultry show, which is held with a particular view to teaching poultry farmers how to secure the largest possible number of eggs. Such a show is an agricultural fair within the meaning of the Act.

**6776** (6) An exhibition of articles of garden produce to stimulate a "garden movement" in the community is an agricultural fair within the meaning of the Act, and admissions to same are not taxable if no part of the net earnings thereof inures to the benefit of any stockholders or members of the organization conducting the exhibition.

**6777** **Art. 29. Claim for exemption.**—The benefit of exemption from Taxes on Admissions or Taxes on Excess Charges can only be secured by executing and filing an affidavit, on Form 755 (Revised), which may be obtained from any Collector of Internal Revenue. On this form must be shown the place and the occasion with respect to which exemption is desired. It must in every case be executed by an officer or duly authorized agent of the organization, or individual, in control of the admissions or excess charges involved. And, where the proceeds of the admissions or excess charges are for the benefit of an organization or of a person or persons not in control thereof, the beneficiary, whether an organization or individual, must join in executing the claim for exemption, space therefor being provided on Form 755 (Revised).

**6778** The claim should be filed with the Collector of Internal Revenue for the district in which is located the place to which the admissions or excess charges covered by the claim are to be sold. It should be filed a considerable length of time prior to any occasion for which exemption is desired, and should be accompanied by evidence to establish the beneficiary's right to exemption under subdivision (b) of section 800. In the case of organizations

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claiming exemption thereunder, copies of their charters or constitutions and by-laws should be submitted in support of such claims. If these documents can not be furnished in any case a comprehensive statement, under oath, outlining the objects and purposes and the scope of the activities of the claimant organization will be required. Unless a claim is filed long enough before any given occasion to permit a full consideration and investigation if necessary and the rendering of a decision, and unless the decision is favorable to the claim, the person or authority in control of the admissions will be liable to the penalty prescribed by section 1302 [§8014] of the Act if tax due on the admissions is not collected. (See Chapter Nine.)

**6779** Collectors of Internal Revenue will notify claimants as to the allowance or disallowance of their claims, as soon as circumstances will permit, on Form 755-A.

**6780** *Examples.*—(1) A certain social club gives an entertainment at which moving pictures are exhibited and charges \$1 for admission. It contends that admissions to this entertainment are exempt from tax on the ground that the net proceeds are to be given to the local chapter of the Red Cross. In such case no claim for exemption can be considered unless the affidavit claiming such exemption is joined in, on behalf of the Red Cross chapter, by one of its officers.

**6781** (2) A football game is to take place at a certain college between its team and that of a rival college. In this case, if an exemption certificate is sought, the president of the college where the game is to be held must execute the affidavit for exemption. If the proceeds are to be divided then the president of the rival college must join in the affidavit.

**6782** (3) The pupils in a certain room in a certain school give an entertainment the proceeds of which are to be used in buying a victrola to be given to the school. In this case, if it is desired to claim that the proceeds are exempt, the principal of the school must, on its behalf, join in the affidavit for exemption.

**6783** (4) A certain lodge gives a benefit for a company of United States soldiers. In this case the claim for exemption on Form 755 (Revised) must be executed by an officer of the lodge and joined in by an officer or other duly authorized member of the company of soldiers.

## CHAPTER SIX

## Tickets and Signs

**6784** Art. 30. Tickets or other means to check admissions required.—  
6508 The above [§6508] is the only provision contained in the Act relating to tickets or cards of admission. It is not held to mean that the use

of tickets or cards in all cases is mandatory; but where tickets or cards are not used some other method or system must be provided by which the number of admissions sold and the tax due thereon may be ascertained and checked. Therefore, every place admission to which is taxable must provide either—

**6785** (a) Tickets or cards of admission to evidence every admission which is subject to tax; or

**6786** (b) A mechanical device which will register the number of persons entering the place.



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**6787** *Exception:* In the case of a person or organization who or which only makes charges for admission irregularly and occasionally and not more than six times a year, compliance with the foregoing requirements will not be necessary; but in such cases a correct record must be kept in accordance with Art. 39 giving all information necessary to enable revenue officers to determine the amount of tax due.

**6788** Art. 31. Requirements applicable to tickets.—Where tickets or cards of admission are used they must comply with the following requirements:

**6789** (1) The price (exclusive of the tax to be paid by the person paying for admission) at which every ticket or card is sold must be conspicuously and indelibly printed, stamped, or written on that part of the ticket which is to be taken up by the management of the place for which it is valid for admission. This is a specific requirement of the Act itself. For administrative purposes it is necessary to show not only the selling price but also (a) the regular or established price (see Art. 11), (b) the tax, and (c) the total of the price and tax. The regular or established price, the tax based thereon, and total shall appear on the *face*<sup>1</sup> of the portion of the ticket which is to be taken up by the management in the following or an equivalent form:

Sale price.....of board, ad., etc.  
Tax paid.....  
Total.....

If the ticket is sold at a price other than the regular or established price, the actual selling price, the tax based thereon, and the total shall be shown on the *back* of the portion of the ticket to be taken up by the management in the following or an equivalent form:

Sale price.....  
Tax paid.....  
Total.....

<sup>1</sup> In the case of strip tickets, the *back* may be used.

**6790** And if the ticket is sold other than at the ticket office of the theater, opera, or other place of amusement, the name and address of the vendor must also be shown on the *back* of the same portion of the ticket. For penalties imposed in this connection see Article 46.

**6791** The foregoing applies primarily to *taxable* admissions. As no tax is imposed on admissions of ten cents or less, it is only necessary that the price of such tickets be shown. This must be shown, since the requirements of the Act in this matter apply to "every admission ticket or card" without regard to the price for which it is sold. Where admissions are exempt on other grounds, the tickets should show that fact. This may be done in the following or equivalent form:

Established price.....  
Tax free.

**6792** (2) The name of the place to which a ticket or card is valid for admission must in all cases be shown thereon. Moreover, tickets must either show the date for which they are valid or must be serially numbered. If serially numbered tickets are used there must be a separate and distinct series for each established price. The numbers of each series must start

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with 1 and run continuously in regular order until 500,000 is reached, after which they may again start at 1 if so desired. In such case, however, a letter of the alphabet must precede or follow the serial number to distinguish the new series from the preceding series, and such letters must be used in turn until the alphabet is exhausted before starting again with the letter A. No place to which taxable admissions are sold shall have, or permit to be, at such place at the same time two or more rolls or series of tickets of the same established price bearing identical serial numbers which are not distinguished by different letters of the alphabet. Serially numbered tickets must be issued consecutively in the order of the serial numbers, and the letters of the alphabet, if any, of that particular series.

**6793** *Exceptions.*—(a) Since tickets or cards of admission which are sold for 10 cents or less are not taxable, they need not be serially numbered or dated.

**6794** (b) In a limited class of cases, the use of so-called "hard tickets" used for repeated performances is permitted without requiring that they be serially numbered or dated.

**6795** In each of these cases, however, the tickets or cards of admission must show the name of the place for which they are valid and the price.

**6796** (3) In the case of bona fide season or subscription tickets a single ticket or card may be used to evidence more than one admission. In every other case, where several single admissions are sold or disposed of at one time, there must be separate or separable coupons to evidence each right to admission. Thus, in the case of combination tickets, issued by outdoor amusement parks, which entitle the holder to admission to a number of different attractions, there must be a separate ticket or coupon for each such attraction. Furthermore, each separate ticket or coupon must either be dated or be serially numbered in accordance with requirements (1) and (2). If serial numbers are used on such combination tickets, each coupon thereof should bear the same serial number as the stub or cover of the ticket itself.

**6797** (4) No person shall be admitted, unless admitted free, to any place admission to which is taxable, and which uses tickets or cards, except upon the presentation of a card or ticket complying with the preceding requirements. The ticket or card so presented or a portion thereof must be taken up, at the time of admission, by the management of the place, except in the case of a bona fide subscription or season ticket covering two or more admissions. Under ordinary circumstances the tickets or cards or portions thereof so taken up need not be preserved by the management of the place, but from time to time, on short notice from a collector of internal revenue or a revenue agent, the management must carefully preserve, until inspection by such officer, all tickets or cards or portions thereof taken upon the occasions designated in such notice.

**6798** (5) In the case of roof gardens, cabarets, and places affording similar entertainment (see Chapter Three), the proprietors must furnish each guest upon payment of his bill for refreshment, service, or merchandise with a coupon receipt to be detached from such bill. All such bills shall be serially numbered and the coupon receipt in each case shall be numbered the same as its bill. The bill and coupon receipt shall each bear in indelible figures the total amount of the charge for refreshment, etc., the tax thereon, which on the receipt shall be stated as "paid," and the sum total of such charge



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and tax. No such receipt shall be delivered except on collecting the amount of the tax so shown on such receipt as "paid."

**6799** *Examples.*—(1) A certain theater has a regular charge of \$2 for orchestra seats. It prints the following on the *face* of that part of the ticket which is taken up by the theater upon the admission of the ticket holder:

Established price.....	\$2.00
Tax paid.....	.20
Total.....	2.20

Two hundred of these tickets are sold by the theater to a certain broker. On selling these tickets he stamps with a rubber stamp on the *back* of the same part of the ticket the following:

This ticket sold by	Sale price.....	\$2.50
Jones & Co.	Tax paid.....	.20
27 West St., New York City.	Total sale price..	2.70

**6800** (2) George Nelson purchases from Jones & Co. one of the tickets mentioned in the preceding example and finding that he is unable to attend the performance he resells this ticket to a friend for the same amount which he paid for it. When selling the ticket George Nelson draws two lines in the form of a cross through the left-hand portion of what the broker had stamped on the back of the ticket and adds his name and address, leaving the inscription on the back of the ticket as follows:

<del>This ticket sold by</del>	Sale price.....	\$2.50	Sold by Geo. Nelson;
<del>Jones &amp; Co.</del>	Tax paid.....	.20	505 West 122d St.,
<del>27 West St., New York City.</del>	Total sale price.	2.70	New York City.

**6801** (3) A certain theater whose established prices are not the same for all attractions desires to print its tickets for the whole year in advance. To comply with the provisions of this Article and yet make it possible to change the established price for various attractions it has tickets printed in the following form:

<b>AMERICAN THEATRE</b>						<b>ORCHESTRA</b>	<b>RIGHT</b>
The established price tax paid and total are as indicated by punch below							
<b>JULY</b>	<b>SATURDAY EVENING</b>					<b>GOOD ONLY</b> <b>SATURDAY EVE.</b> <b>JULY 22 1922</b>	
<b>22</b>	<b>ORCHESTRA</b>						
<b>1922</b>	Established price	.75	\$1.00	\$1.50	\$2.00		\$2.50
	Tax paid	.08	.10	.15	.20		.25
	Total	.83	\$1.10	\$1.65	\$2.20		\$2.75
	★	★	★	★	★		
Not valid unless one star is punched out							

Tickets so printed, if properly punched in advance of the opening of any sale or distribution of tickets for the performance for which they are issued, will fully comply with the requirements of Article 30, as well as with those of this Article.

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**6802** (4) Certain society women form an organization for the sole purpose of giving a single ball the net proceeds from which are to be given to a charity hospital. In this case, if it is decided to use tickets, the tickets must be marked with the "established price" in accordance with the provisions of this Article. No "tax paid" or "total" need be printed on the tickets, however, because the admissions are clearly exempt from tax, but "tax free" or its equivalent must appear in its stead.

**6803** (5) A broker on reselling a ticket finds that by reason of the fact that it has previously passed through the hands of several other brokers and has been stamped by them, there is not sufficient space on it for him to stamp the information required by the law and regulations. He may enlarge the ticket by pasting on to that part which will be taken up by the theater a slip of paper and stamp the required information on the same, but this must be done in such a way that the information placed on the ticket by former vendors will not be obscured.

**6804** (6) A college procures tickets to be sold for admission to a football game, on admissions to which it has secured exemption from tax. The tickets must show the established price of admission and bear the words "Tax free."

**6805 Art. 32. Printing of tickets—Notice to be Given.**—Where tickets or cards of admission to any place for admission to which a charge is made are printed, manufactured, or sold by any person, it shall be the duty of that person to give prompt notice to the collector of internal revenue of the district in which is located the place to which admission is to be charged. Such notice shall state (1) the name and address of the person to whom the tickets are furnished and (2) the number of tickets furnished, and shall be accompanied by proofs or sample copies of the tickets themselves. If the tickets are serially numbered, the notice must also contain a statement as to such serial numbers.

**6806 Art. 33. Mechanical devices.**—If a mechanical device is used instead of tickets or cards of admission, such device may be placed at the entrance or exit, or at any point en route through the place, but must be so arranged that every person admitted must himself cause it to register an admission and be so constructed that no change can be made in the record of admissions until at least 99,999 admissions are recorded, and then the only change possible must be the returning of the record to "0".

**6807 Art. 34. Signs to be posted.**—In the case of every place, admission to which is subject to tax, the proprietor or manager must keep conspicuously posted at the outer entrance and near the box office one or more signs accurately stating each of the established prices of admission, and in the case of each such price the tax due and the sum total of the established price and the tax.

**6808 Examples:** The following are examples of such signs:

(1) In the case of a "legitimate" theater:

	Admission	Tax	Total
Box seats.....	\$2.00	\$0.20	\$2.20
1st 10 rows of orchestra.....	1.50	.15	1.65
Balance of orchestra.....	1.00	.10	1.10
1st 4 rows of balcony.....	.75	.08	.83
Balance of balcony.....	.50	.05	.55
Gallery.....	.25	.03	.28



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		Balcony	Orchestra
Admission.....	13c	Admission.....	27c
Tax.....	2c	Tax.....	3c
Total.....	15c	Total.....	30c

**CHAPTER SEVEN****Collection, Return, and Payment of Tax.**

Law ¶5506, ¶5508-9, ¶6512, ¶8009-10

**6810 Art. 35. Duty to collect, return, and pay tax—Taxes on Admissions.**

**6512** —Every individual, corporation, partnership, or association (1) receiving any taxable payment for admission must collect the tax from the person making such payment at the time such payment is made; (2) being the proprietor or manager of an opera house or any other place of amusement in a case where any person has the permanent use or a lease for the use of a box or seat therein which is subject to tax must collect the tax from the owner or lessee of such box or seat; or (3) receiving payment for refreshment, service, or merchandise, which is taxable because including therein a charge for admission to a public performance for profit, at any roof garden, cabaret, or other similar entertainment, must collect the tax from the person making such payment at the time of such payment.

**6811** A ticket broker or other person reselling a ticket at an advance over the former sale price may collect, and retain as a refund to him, the amount of admission tax already paid on that admission by him. A theater issuing a ticket in exchange for a less expensive ticket and a cash balance must collect the admission tax due on the cash balance.

**6812** If the permanent use or lease for the use of a box or seat is paid for, then the time for the collection of the tax is the same as that in the case of any other paid admission. If the right to use is granted free or is otherwise enjoyed without being directly paid for, then the tax must be collected at the time the right is granted. If these rules prove insufficient, by reason of attempts at evasion or otherwise, to provide for the collection of the full tax due in any such case, then the proprietor or manager of the opera house or other place of amusement in which such box or seat is located shall collect each month, from the person entitled to the use of such box or seat, any balance of tax due from such person for the right to the use of such box or seat during the preceding month.

**6813** In the rare cases where payment for refreshment, service, or merchandise is not made before or at the time of leaving the roof garden, cabaret, or other place of entertainment, payment must be treated as having been made and the tax must be then collected. Credit can be given for the amount paid for refreshment, service, or merchandise, if desired, but not for the tax. The tax must be collected not later than the departure of the person from the place of the performance at the conclusion of such performance.

**6814** In each case there rests on the respective person from whom the tax is to be collected the corresponding duty of then paying such tax. A monthly return and payment of all such collections must be made in accordance with the provisions of Art. 41.

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**6815 Art. 36. Duty to return and pay tax—Taxes on Charges in Excess of Established Price.**—Every individual, corporation, partnership, or association selling or disposing of a ticket or card of admission at a price in excess of the established price of the admission for which such ticket or card is valid in a case where such excess is taxable shall make a monthly return and pay the tax due in accordance with the provisions of Art. 41. For penalties see Art. 46.

**6816** A broker may reimburse himself in an amount equal to a tax imposed under the provisions of section 800 (a), paragraph (1) of the Act, which he has paid to the vendor from whom he purchased the ticket, providing the selling price and tax imposed thereon under section 800 (a), paragraph (1), are properly stamped, printed, or written on the ticket in accordance with the provisions of section 800 (d) of the Act and Art. 31 of these Regulations. No credit can be taken, however, for any tax imposed under section 800 (a), paragraph (2) or (3), on excess charges and paid by the vendor from whom the broker purchased the ticket unless the broker claiming such credit obtains from the vendor a written statement that such vendor has paid or will pay the amount of tax on excess charges for which the purchasing broker claims credit. The statement must be preserved by the broker claiming credit in such a way as to be readily accessible for inspection by internal revenue officers. (See Arts. 12 and 13.)

**6817 Art. 37. Application for and certificate of registry.**—Every individual, corporation, partnership, or association (1) required by the provisions of the Act to collect any tax on admissions (see Art. 35) or (2) being the owner or lessee of any place which is ordinarily or at times leased to other persons who impose charges for admissions to it (see Art. 42) or (3) required to pay any tax on charges in excess of established price (see Art. 36) shall annually, on or before the first day of July, (and if not on that date engaged in business, then within ten days after engaging in business and annually thereafter on or before the first day of July) make an application for registry, by filling out Form 752 (Revised), with all information there called for, and duly executing it under oath. In cases falling within the first of the above classes (except such as are considered in Art. 38) such an application must be filed in the office of the collector of internal revenue of each district in which is located a place to which admissions are charged on account of which a duty to collect admissions taxes is imposed on the person making such application. In cases falling within class (2) the application must be filed in the office of the collector of internal revenue of each district in which such a place is owned or leased. In cases falling within class (3) the application must be filed in the office of the collector of internal revenue of the district in which is located the principal place of business of the person making the application, or in which is located his residence, if he have no fixed place of business. The collector, if satisfied that all the statements made in the application for registry are correct, will issue a certificate of registry on Form 753 (Revised) to the person who made such application. This certificate must be kept conspicuously posted in the principal place of business of such person, or be carried about with him, if he has no fixed place of business.

**6818 Example.**—A certain hotel has a number of rooms which it rents from time to time for dances and other parties. This hotel falls within class (2) of Art. 37 and must annually make application for registry. (This Article is as amended by T. D. 3394, Sept. 21, 1922.)



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**6819 Art. 38. Traveling shows.**—The proprietor or manager of every show, circus, exhibition, Chautauqua, or other amusement enterprise, which is traveling or itinerant, shall file the application for registry required by Art. 37 with the collector of internal revenue of the district in which the headquarters of such show is located, if it have an established headquarters. If it have no established headquarters, then the application shall be filed with the collector of the district in which such proprietor or manager resides. The certificate of registry, the daily record required by Art. 39, and a copy of each monthly return (see Art. 41) must be carried along with the show and exhibited on request to collectors of other districts or to internal revenue agents.

**6820** This article applies only to shows, etc., which control the sale of tickets to their performances and the collection of tax on the same. It does not include, therefore, traveling theatrical attractions, lyceum entertainers, or the like, who perform in theaters or other places where the local management controls the sale of tickets and the collection of the tax.

**6821 Examples.**—(1) A certain Chautauqua has its main office in a certain city. The lectures, entertainments, and other attractions which it furnishes constantly tour the country, moving from State to State. In this case the application for registry must be made with the collector of internal revenue of the district in which its main office is located.

**6822** (2) A certain theatrical company, acting in a farce comedy, tours the country, playing in various theaters. All of these theaters have certificates of registry, and they take care of all matters connected with the sale of tickets, collection of tax, etc. Such a company does not fall within the provisions of Art. 37 or 38 and is not required to apply for a certificate of registry at all.

**6823 Art. 39. Records—Taxes on Admissions.**—Every individual, corporation, partnership, or association required by the provisions of the Act to collect any tax on admissions must keep or cause to be kept an accurate daily record showing (1) in the case of each class of Taxes on Admissions (a) all figures and other information necessary to determine the amount of tax due for that day, and (b) the amount of tax due for that day, and (2) the total amount due as Taxes on Admissions for that day. The proprietor or manager of the business must certify, over his signature, to the correctness of the daily record, and if any other person is directly interested in the proceeds of the amounts received for admission, he or his agent must also so certify it. Whenever in the course of the business a report is prepared daily or at some other regular interval or at any time by a treasurer or manager for the benefit of the proprietor, or by the proprietor, treasurer, or manager for the benefit of some other interested party, a sworn copy of such report must be attached to and made a part of such daily record. Indeed, if such a report contains all the information required above, no daily record other than the sworn copy of the report need be kept. But whatever information such a report may contain, a sworn copy of it *must* be made and kept. Such daily records, including such sworn copies of reports, must be kept on file at the box office of the place or at some other convenient location for a period of two years, in such a manner as to be readily accessible on request to internal revenue officers.

**TAX ON ADMISSIONS AND DUES REGULATIONS.**

**6824** The records should be kept in substantially the following form:

Page—

**MONTHLY RECORD OF ADMISSION TAX.**

Class of admissions, \$.....

Month of.....

Day of month	Tickets sold	Price	Tax
1	From.....		
	To.....		
2	From.....		
	To.....		
3	From.....		
	To.....		
4	From.....		
	To.....		
5	From.....		
	To.....		
6	From.....		
	To.....		
7	From.....		
	To.....		
	Total.....		

Tax due for seven days ending....., 19...., \$.....

NOTE.—Under column "Tickets sold" show after (From) the number of the first ticket sold, and after (to) show the number of the last ticket sold. A separate record must be kept for each class of admissions.

[Similar page for the 2nd, 3rd, and 4th seven-days of the month.]



## TAX ON ADMISSIONS AND DUES REGULATIONS.

Page—

## MONTHLY RECORD OF ADMISSION TAX.

Class of admission, \$.....

Month of.....

Day of month	Tickets sold	Price	Tax
29	From.....		
	To.....		
30	From.....		
	To.....		
31	From.....		
	To.....		

Taxes due for the first seven days of the month.....	\$.....
Taxes due for the second seven days of the month.....	\$.....
Taxes due for the third seven days of the month.....	\$.....
Taxes due for the fourth seven days of the month.....	\$.....
Taxes due for last days of the month.....	\$.....

Total taxes due for the month..... \$.....

See that each page is properly numbered, consecutively, for the entire year. When a year's records are complete, file away for reference and refill your book for another year.

**6825 Art. 40. Records—Taxes on charges in excess of established price.—**

Every individual, corporation, partnership, or association required by the provisions of the Act to pay any tax on charges in excess of established price, must keep or cause to be kept a daily record which classifies all sales of tickets into classes in each of which all the tickets are identical in respect to (1) the place to which admission is granted by the ticket, (2) the established price (exclusive of admission tax) of the admission granted by the ticket, and (3) the actual price (exclusive of any amount representing an admission tax) at which that sale of the ticket is made. This daily record must show (1) in the case of each such class (a) all figures and other information necessary to determine the amount of tax due for that day, and (b) the amount of tax due for that day, and (2) the total amount due as Taxes on Charges in Excess of Established Price for that day. Whenever in the course of the business a report is prepared daily or at some other regular interval or at any time by a treasurer or manager for the benefit of the proprietor, or by the proprietor, treasurer, or manager for the benefit of some other interested party, a sworn copy of such report must be attached to and made a part of such daily record. Indeed, if such a report contains all the information required above, no daily record other than the sworn copy of the report need be kept. But whatever information such a report may contain, a sworn copy of it *must* be made and kept. Such daily records, including such sworn copies of reports, must be kept on file at the place of business, or at some other convenient location, for a period of two years, in such a manner as to be readily accessible on request to internal-revenue officers.

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**6826 Art. 41. Returns and payments.**—Every individual, corporation, partnership, or association required under the provisions of Article 13 of these regulations to pay any tax on excess charges shall make up each month from the daily record, required by Art. 40, a return in duplicate on Form 729A, in accordance with the instructions printed on the back of that form. Every other individual, corporation, partnership, or association required by the provisions of the Act to collect any tax on admissions (see Art. 35) or to pay any tax on charges in excess of established price (see Art. 36) shall make up each month from the daily record, required by Art. 39 or 40, as the case may be, a return in duplicate on Form 729 (revised), in accordance with the instructions printed on the back of that form. In addition thereto, proprietors of places who sell admission tickets to or through brokers must make up for each month from the daily record a return in duplicate on Form 729B in accordance with the instructions printed on that form. These returns must be made under oath, and must be verified before an officer duly authorized to administer oaths, either by the laws of the United States or by the laws of the State or Territory where such officer resides. Persons in the military or naval service of the United States may verify their returns before any official authorized to administer oaths for the purpose of those services. Such return or returns, together with the amount of the tax, must be in the hands of the collector of internal revenue who issued the certificate of registry for the place or business for which such return and payment is being made, *on or before the last day of the month following that for which it is made.*<sup>1</sup> (For penalties see Art. 46.) A copy of the proper form (or forms) will, as far as possible, be mailed each month to every person that filed a return during the preceding month, but should any person who is liable to tax fail to receive a blank return he should take the necessary steps to secure a form and make return within the time prescribed by law, as a failure to receive such copy from the collector will not, of course, excuse a failure to return and pay the tax, or relieve the taxpayer from the penalties for delinquency.

**6827 Art. 42. Leases of places.**—Whenever a theater, hall, park, ball-room, or other place is leased<sup>2</sup> for any occasion, there is imposed on the lessee, by the provisions of the Act, the duty of collecting any taxes due on admissions to such place on that occasion. However, for the convenience of the parties and the safeguarding of the revenue, the lessor will be permitted, if properly registered in accordance with Art. 37, to assume the responsibility for the collection of the tax in such cases. If the lessor assumes such responsibility his tickets shall be used<sup>3</sup> and the daily record required by Art. 39 shall be kept as a part of the daily records of the lessor in the same manner and form as if there had been no lease of the place on that occasion; with the exception, however, that the name of the lessee must also appear on the daily record and that he must also certify to the correctness of such record. If the lessor, however, does not assume responsibility for the collection of the tax, the lessee, precisely like any other person collecting taxable admissions, must comply in all respects with these regulations, more particularly

<sup>1</sup> "To the collector of the district in which the principal office or place of business is located," in Section 502 of the Act, means (1) if there is a definitely located place to which admission is charged, to the collector of the district in which such place of business is located; or (2) if the business is not definitely located but traveling or itinerant, to the collector of the district in which is located the principal office of such business or, if it has no office, the residence of its proprietor.

<sup>2</sup> Where a person, society, or organization acquires the right to dispose of all the admissions to any place for one or more occasions the transaction amounts to a lease of such place within the meaning of this article.

<sup>3</sup> If the lessee issues general admission tickets these tickets must not entitle to admission but be merely exchangeable for tickets of the lessor entitling to admission.



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with Art. 35, 36, 39, 40 and 41. Every lessee or person who rents any theater, hall, park, ballroom, or other place for a term or period not exceeding 10 days, and who assumes responsibility for collecting and making return on Form 729 of taxable admission charges, shall furnish immediately after each performance or occasion for which admission charges are collected, to the collector of the district in which such theater, hall, ballroom, or other place is located, a sworn statement on Form 827 showing the number of persons admitted, the amount paid for admission by each, the amount of tax collected, and the permanent address of the person responsible for making return on Form 729. It shall be the duty of every lessor or person who rents out any theater, hall, park, ballroom, or other place to furnish to the person leasing or renting the same a sufficient number of copies of Form 827 at the time of such lease or rental. Moreover, in such case the lessor, before or at the time of making the lease, must notify the collector of internal revenue of the district in which the place is located on Form 754 (Revised) that such lease is being made. The lessor of any such place, whenever he makes a lease, shall furnish the lessee with a copy of Form 755 (Revised), in order that the lessee may promptly claim any exemption to which he may be entitled. (See Art. 29.)

## CHAPTER EIGHT

## Credits and Refunds

## Law ¶8018, ¶8023, ¶8057

**6828 Art. 43. Credit for overpayment.**—Any individual, corporation, partnership, or association that has paid to the collector of internal revenue, as a tax under section 800 of the Act, any amount in excess of the amount of the tax actually imposed by that section for the month covered by that payment, is authorized under section 1304 of the Act to claim credit for such overpayment against the amount of the tax imposed by section 800 which is due upon any other monthly return thereafter made in the same behalf on Form 729 (Revised) or on Form 729A (Revised).

**6829** In case a credit is claimed a statement shall be attached to the return setting forth fully the facts regarding the alleged overpayment or overcollection. In the case of the overcollection of a tax no credit for the amount overcollected shall be allowed until the individual, corporation, partnership, or association making the overcollection submits a sworn statement that the tax in each case so overcollected has been returned to the person making the overpayment.

**6830** It should be noted that the right to claim a credit exists only in the case of "overpayment or overcollection." These words are confined in general to cases where as the result of some clerical or mechanical error, an excess amount has been collected or paid.

**6831 Art. 44. Refund of erroneous or illegal collections.**—In all cases where tax has been collected and such collections are alleged to be *illegal or erroneous* it will be necessary for the person so paying the tax to file claim for refund on Treasury Department Form 46. Section 1304 of the Act does not authorize the individuals, corporations, partnerships, or associations receiving such tax to make refund nor to adjust the claim; the only adjustment authorized under this section of the Act being limited to cases of *overpayment or overcollection* of tax.

## TAX ON ADMISSIONS AND DUES REGULATIONS.

**6832 Art. 45. Refund of overcollection.**—Every individual, corporation, partnership, or association that has collected from any person, as a tax under section 800 of the Act, any amount in excess of the amount of the tax imposed by that section actually due from such person, shall upon proper application promptly refund such amount to the person entitled thereto, even though such amount has already been paid over to the collector of internal revenue and no corresponding credit (see Art. 43) has yet been secured. As the tax on admissions is based on the *payment* not the *admission*, no refund of any part of such a tax is authorized merely because the person paying for admission does not actually make use of his right to admission. Where, however, an amount paid for admission is refunded it will be treated, as far as the liability to the tax is concerned, as not having been paid, and the amount of any tax collected at the time of the payment should itself be refunded to the taxpayer by the person refunding the payment, at the same time the payment is refunded. As the tax on the permanent use or a lease for the use of a box or seat is based on the *right to use* (see Art. 6), it is entirely immaterial whether the box or seat is ever used or not, and, therefore, no refund can ever be granted on the ground that there was no actual use of the box or seat.

## CHAPTER NINE

## Penalties

Law ¶5509, ¶6508, ¶8014-17, ¶8073-74

**6833 Analysis of above provision of Revenue Act of 1921.**

Act or default penalized	Penalty applicable	Section of Revenue Act of 1921
Sale of "admission ticket or card on" the "face or back" of "which the name of the vendor" ("if sold other than at the ticket office of the theater, opera, or other place of amusement") and the "price (exclusive of the tax to be paid by the person paying for admission) at which" the "ticket or card is sold" is not "conspicuously and indelibly printed, stamped, or written"; or sale of an admission ticket or card "at a price in excess of the price so printed, stamped, or written thereon."	Fine of not more than \$100.	800 (d).

[Continued on page 1363.]



## TAX ON ADMISSIONS AND DUES REGULATIONS.

## Analysis of above Provision of Revenue Act of 1921—Continued.

Act or default penalized	Penalty applicable	Section of Revenue Act of 1921
"Failure to make and file" return "within the time prescribed" (when return not filed later and reasonable cause shown for failure to file in time).	25 per cent addition to tax (to be collected as part of tax, or if tax already collected then in same manner as tax).	Section 3176 U. S. Revised Statutes, as reenacted by section 1311.
Willfully making "false or fraudulent return."	50 per cent addition to tax (to be collected as above).	Do.
Failure to pay tax when due.....	5 per cent addition to tax..... and 1 per cent interest for each full month from time tax due.	502 or 903.
Failure by any "person" <sup>1</sup> to "pay, collect, or truly account for and pay over any such tax, make any such return, or supply any such information at the time or times required by law or regulation."	Penalty of not more than \$1,000	1302 (a).
Willful refusal by any "person" <sup>1</sup> to "pay, collect, or truly account for and pay over any such tax, make such return or supply such information at the time or times required by law or regulation," or willful attempt "in any manner to evade such tax."	Fine of not more than \$10,000.. or Imprisonment for not more than one year, or both.	1302 (b).
Willful refusal by any "person" <sup>1</sup> to "pay, collect, or truly account for and pay over any such tax."	100 per cent addition to tax....	1302 (c).
Embezzlement of money of United States.	Fine of not more than \$5,000... or Imprisonment for not more than 5 years.	Section 47 U.S. Criminal Code.

<sup>1</sup> "Person" includes "an officer or employee of a corporation or a member or employee of a partnership, who as such officer, employee, or member is under a duty to perform the act in respect of which the violation occurs." (Section 1302 (d).)

<sup>2</sup> "No penalty shall be assessed under this subdivision for any offense for which a penalty may be assessed under authority of section 3176 of the Revised Statutes, as amended." (Section 1302 (c).)

**6834 Art. 46. Penalties.**—The scope of the penalties applicable to the Tax on Admissions is so broad that reference will be made only to their most common applications. Every individual, corporation, partnership, or association, on which there rests a duty to file a monthly return on Form 729 (Revised), that fails to file such return, and to pay over the tax due thereon, during the month which follows that for which such return should be made, is subject to certain penalties. A mere failure to *file the return* within that following month causes to accrue the 25 per cent penalty imposed by section 3176 of the Revised Statutes, as amended. If the failure be willful the penalty is 50 per cent instead of 25 per cent. A mere failure to *pay to the collector* during the month which follows that for which such return should be made, all taxes due under that return, causes to accrue, under section 502 of the Revenue Act of 1921, a penalty of 5 per cent, and of interest at 1 per

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**TAX ON ADMISSIONS AND DUES REGULATIONS.**

cent per month for each full month of delay. Every person who fails to pay at the proper time the amount of the taxes due is also subject, under section 1302 of the Revenue Act of 1921, to a penalty of not more than \$1,000. If this failure amounts to a willful refusal to pay, or an attempt to evade the tax, he is guilty of a misdemeanor and subject to a fine of not more than \$10,000, or imprisonment for not more than one year, or both, and he is, moreover, liable to a penalty of 100 per cent of the amount of the tax. These penalties apply as well to an officer or employee of a place, or attraction, or ticket-selling business, who fails to perform a duty with regard to the Tax on Admissions, as to a person who fails or refuses to pay his tax. A willful conversion to one's own use of any tax collected under this act constitutes embezzlement, which is punishable by fine of not more than \$5,000 or imprisonment for not more than five years, or both.

**6835 Example.**—A certain theater which sells about \$1,000 worth of taxable admission tickets each month, regularly collects the taxes due on such admissions, but the treasurer carelessly fails to file a return and pay over the taxes for April, May, and June, 1922, until September 2, 1922. The taxes collected in April are \$110, in May \$100, and in June \$120. In this case the penalties are as follows:

**April:**

Taxes collected.....	\$110.00	
25 per cent penalty.....	\$27.50	
5 per cent penalty.....	5.50	
3 months' interest at 1 per cent.....	4.29	
		<u>\$37.29</u>

**May:**

Taxes collected.....	100.00	
25 per cent penalty.....	25.00	
5 per cent penalty.....	5.00	
2 months' interest at 1 per cent.....	2.60	
		<u>32.60</u>

Forward.....	69.89
Brought forward.....	69.89

**June:**

Taxes collected.....	\$120.00	
25 per cent penalty.....	\$30.00	
5 per cent penalty.....	6.00	
1 month's interest at 1 per cent.....	1.56	
		<u>\$37.56</u>

Total penalties..... 107.45

In addition the theater treasurer is liable to a penalty of not more than \$1,000.

**AUTHORITY FOR REGULATIONS**

**6836 Art. 47. Promulgation of regulations.**—In pursuance of this provision [18009] of the Act the foregoing regulations are hereby made and promulgated and all rulings inconsistent with them are hereby revoked.

D. H. BLAIR,  
Commissioner of Internal Revenue.

Approved February 15, 1922 [Released for publication February 28, 1922.]

A. W. MELLON,  
Secretary of the Treasury



## TAX ON ADMISSIONS AND DUES REGULATIONS.

(T. D. 3431.)

**6837** **Skating rinks: Charge for skate tickets: Court Decision.**—The decision of the District Court of the United States, Western District of Washington, Southern Division, in the case of United States v. G. H. Koller and F. M. Farmer, the syllabus of which appears below [¶6838] is published not as a ruling of the Treasury Department, but for the information of internal revenue officers and others concerned. (T. D. 3431, signed by Commissioner D. H. Blair, and dated January 22, 1923.)

[The syllabus referred to in ¶6837, above, follows.]

**6838** 1. *Nature of tax.*—The admissions tax imposed by Section 800 of the Revenue Act of 1918 is an excise tax.

**6839** 2. *Skating Rinks: Charge for Skate Tickets: Taxability.*—Where the owner of a skating rink which has operated for the general public makes an admission charge at the door of nine cents plus war tax of one cent, total ten cents, and a further charge for skate tickets which entitle the purchasers thereof to use the floor of said skating rink without extra charge, whether they use their own skates or those furnished by the said rink, the charge for skate tickets is not a rental for skates but is in fact a charge for admission to the skating floor, and is subject to the excise tax imposed by Section 800 (a) (1) and (c) of the Revenue Act of 1918.

**6840** 3. *Regulations Approved.*—Article 15 [now Art. 3, ¶6601; see beginning at ¶6617], Regulations No. 43 (Revised), Part I, is approved. (Syllabus referred to and made a part of T. D. 3431, ¶6837.)

(T. D. 3439.)

**6841** **Formal regulations relating to the tax on dues, amended.**—Articles 9, 10, 11, and 12, Regulations 43, Part 2, Revised April, 1922, are hereby amended to read as follows [See ¶6881]:

**6842** **Art. 9. Dues or membership fees.**—The Revenue Act of 1921 imposes a tax of 10 per cent on any amount paid as dues or membership fees (including all assessments except that portion thereof imposed for capital expenditures, and penalties incurred by failure to pay promptly) to any club which is within the terms of the Act: *Provided*, That the regular dues or membership fees (including all assessments except that portion thereof imposed for capital expenditures levied upon all active resident annual members but not including penalties incurred by failure to pay promptly) of an "active resident annual member" of such club are in excess of \$10 per year. "An active resident annual member" is a member who is neither a life nor a nonresident member, but who in other respects enjoys full club privileges, as distinguished from the restricted privileges enjoyed by a person holding an associate or other partial membership. The phrase "imposed for capital expenditures" includes only those assessments or portions thereof which are levied or imposed in good faith to meet specified capital expenditures.

**6843** Thus in the case of a club or organization the regular dues or membership fees of which are less than \$10 per year, but which levies an assessment on its active resident annual members each year, if the regular dues or membership fees, plus that portion of the assessment not imposed for capital expenditures, exceed \$10 per year, the tax is applicable. The tax

## TAX ON ADMISSIONS AND DUES REGULATIONS.

would likewise apply in the case of a club or organization which collects no regular dues or membership fees but meets its expenses by levying assessments on its members as funds are required, provided, of course, such portions of the assessments not imposed for capital expenditures aggregate more than \$10 per year for members who enjoy the full privileges of the club or organization.

**6844** Where the dues or membership fees, determined in the manner herein outlined, of an active resident annual member are in excess of \$10 per year, dues or membership fees paid by other classes of members, whether or not they are in excess of \$10 per year, are subject to the tax. So, also are extra charges which are imposed upon members for the privilege of using certain additional facilities for a period of time, as, for example, an additional charge of \$60 per annum imposed upon members of a country club for the privilege of using the golf links. A "greens fee" charged to a guest is not taxable, unless the right or privilege granted in return is for a period of time, such as a season. A fine imposed for the violation of rules promulgated by a club or organization would be neither dues nor membership fees within the meaning of the Act, and therefore not taxable.

**6845** As to the time for payment of the tax, see article 12 [¶6878].

**6846** *Examples.*—(1) A certain social club has "members," nonresident members, associate members, and junior members. "Members" pay an initiation fee of \$15 and regular dues of \$10 per year. Associate members pay an initiation fee of \$10 and regular dues of \$5 per year. Nonresident members and junior members pay still less. In the case of this club a "member" is clearly the "active resident annual member" specified in the Act. As a "member's" regular dues are not in excess of \$10 per year, none of the dues or membership fees paid by any member of the club are taxable. (The initiation fee of \$15 paid by a "member" is taxable.)

**6847** (2) A certain athletic club had members, dues, and fees precisely the same as those of this social club, except that the initiation fee of "members" is \$10 and the regular dues of "members" are \$15 per year. As these dues are in excess of \$10 per year, in this case all dues paid to the club by members of any class are subject to tax.

**6848** (3) The same athletic club levies in a certain year, in addition to its regular dues, an assessment (for other than capital expenditures) of \$10 on every associate member and provides a penalty of \$1 if it be not paid within a month after due. This assessment is taxable, and so is the penalty if it be imposed.

**6849** (4) A member of this same athletic club violates the house rules and is suspended until he pays a fine of \$15. As a fine is neither dues nor membership fees, this \$15 payment is not taxable.

**6850** (5) A certain golf club's dues are \$15 per year. Of this amount \$10 is expended in the purchase for the member of a season ticket to a municipal golf course. The whole \$15 is, nevertheless, taxable as dues.

**6851** (6) A certain golf club charges a "green" fee of \$1 for each guest that uses the course. Such a fee is not paid "as dues or membership fees," and is, therefore, not taxable as such.

**6852** (7) The members of a certain curling club pay annual dues of \$20. By the payment of \$10 extra per year the privilege of skating on the club's rink can be secured for the member's family. A payment of this extra \$10 is taxable as a membership fee.

**6853** (8) A certain social club, the regular dues of which are \$15 per year, has honorary members who pay no dues, but pay assessments when



## TAX ON ADMISSIONS AND DUES REGULATIONS.

levied. Such members must pay tax on such portion of the assessments which may be levied for other than capital expenditures.

**6854** (9) A tennis club in which the annual dues are \$10, levies an assessment of \$2.00 per year on each member to cover cost of tennis balls.

The dues, fees, and such assessments paid by members of this club are taxable.

**6855** (10) A certain club, the dues and fees of which are taxable, requests a "subscription" of a definite amount from each resident member.

Amounts paid by reason of such requests are taxable if intended to be used for purposes other than capital expenditures.

**6856** (11) A social club, the annual dues of which are \$10, levies an assessment of \$5 on members, which assessment is imposed for other than capital expenditures. The tax applies with respect to amounts paid as dues, fees, and such assessments.

**6857** (12) A certain social club, the dues and fees of which are taxable, passes a resolution providing that no membership dues or fees shall be collected from members who are in the military service of the United States. Such members thereafter pay no dues or fees and are therefore not liable for payment of tax with respect to membership in the club, but this does not relieve life members who are in the military service from payment of the tax on their life memberships.

**6858** (13) A certain golf club, the dues and fees of which are taxable, issues to wives of members cards entitling them to the use of the course for one year, making a charge of \$10 therefor. The amounts paid for such cards are taxable.

**6859** (14) The membership of a certain social club is composed of its stockholders. No dues are collected, but the expenses of the club are met by annual assessments of the necessary amount on each share of stock. If a stockholder enjoying full privileges of the club must pay assessments aggregating more than \$10 per year, then the tax applies with respect to all assessments imposed by the club on its stockholders for other than capital expenditures, whether in excess of \$10 per year or not.

**6860** (15) A golf club levied an assessment on its members for the following purposes, to each of which a specified amount was assigned: to take up and redeem bonds soon to become due; to build a new barn on the club property; to purchase a tractor motor; to purchase and retire special memberships; to pay off a deficit from operations for the preceding year. The tax applies only to that part of the assessment imposed for the purpose of paying off the deficit, which is an assessment for running expenses; the remainder of the assessment was imposed for capital expenditures and is not taxable.

**6861** **Art. 10. Initiation fees.**—Any amount paid as initiation fees to a club or organization coming within the provisions of section 801 of the Act to is subject to the 10 per cent tax imposed thereunder (a) if such fees amount to more than \$10, or (b) if the dues or membership fees (not including initiation fees) of an active resident annual member are in excess of \$10 per year.

**6862** If the prescribed initiation fees amount to more than \$10, the tax attaches regardless of the amount of dues or membership fees paid by an active resident annual member. On the other hand, if the initiation fees amount to less than \$10, the tax does not apply unless the dues or membership fees, exclusive of initiation fees, of an active resident annual member are in excess of \$10 per year. If such dues or membership fees are in excess of \$10 per year any amount paid as initiation fees is taxable whether or not such initiation fees amount to more than \$10.

## TAX ON ADMISSIONS AND DUES REGULATIONS.

**6863** Where the application of the tax to initiation fees depends upon the amount paid as dues or membership fees by an active resident annual member, assessments other than those imposed for capital expenditures (but not penalties incurred by failure to pay promptly) are to be considered in ascertaining whether such dues or membership fees are in excess of \$10 per year.

**6864** The term "initiation fee" includes any payment to the club required for becoming a member, whether evidenced by a certificate of membership or a share of stock in the club or not. Thus, it includes amounts paid to such clubs or organizations for stock where the purchase of such stock is required as a prerequisite of membership. This applies only to stock purchased from the club or organization and not to amounts paid for stock purchased from retiring members or other sources.

**6865** *Examples.*—(1) In the case of the social club described in the first example of article 9, above [¶6846], an initiation fee paid by a "member" is taxable because it amounts to more than \$10, but initiation fees paid by members of the other classes are not taxable.

**6866** (2) In the case of the athletic club described in the second example in article 9, above, initiation fees paid by members of any class are taxable, because the regular dues of "an active resident annual member" are in excess of \$10 per year.

**6867** (3) A certain tennis club is a stock corporation and each new member has to buy a share of stock in the club. The amount paid for this share of stock is taxable as an initiation fee.

**6868** (4) The land of this same tennis club is owned by a corporation, organized for that purpose, in which many of the club members own stock. Money being desired to buy additional land, it is decided to admit no new members to the club except such as will buy, in addition to the share of stock in the club itself, one share of stock in the land-owning corporation. Money paid for this stock in the land-owning corporation is not taxable as an initiation fee.

**6869** (5) The same tennis club, at a later stage of its career, drops the requirement of the purchase of stock in the land-owning corporation, but requires each applicant for membership, in addition to paying for his share of stock in the club corporation, to purchase a first mortgage bond secured by the club property. The amount paid for this bond is not taxable as an initiation fee.

**6870** *Art. 11. Life membership.*—Amounts paid for life membership are 6561 not taxable under the Revenue Act of 1921. Neither were such 6562 to payments subject to the tax imposed under section 801 of the Revenue 6563 Act of 1918; but they were taxable under the Revenue Act of 1917.

The fact that tax was collected on amounts paid for life membership while the latter Act was in force does not entitle holders of live memberships who paid such tax to exemption from paying annually under the 1918 and 1921 Acts a tax equivalent to that paid by active resident annual members. Some clubs provide that active resident annual members, who have regularly paid dues or membership fees as such shall, after a specified period of time, for example, 10 years, automatically become life members without being required to pay further dues or membership fees. In such cases amounts paid as dues or membership fees during the period of active resident annual membership are not paid for life membership within the meaning of the Act. They are paid as dues or membership fees and are taxable as such. The tax likewise attaches to amounts paid for membership for more than one year



but for less than life, such as 10-year or 20-year memberships. However, unless the holders of such memberships are required to pay annual dues or membership fees, or assessments imposed for other than capital expenditures, they are exempt from the annual tax imposed on active resident annual members and life members. If any dues or membership fees or such assessments are levied on such members they are taxable.

**6871** The annual tax imposed on life members under the Revenue Act of 1921 is measured or determined by the tax paid by active resident annual members, to be computed in the manner outlined in article 9 [¶6842]. The annual tax must be paid by life members whether or not they actually avail themselves of the privileges of membership to which they are entitled.

**6872** As to the time for the payment of the tax, see article 12 [¶6878].

**6873** *Examples.*—(1) A certain tennis club has the following classes of membership: Honorary, life voting, voting, nonresident, women's and junior. Here evidently a voting member is the "active resident annual member" specified in the Revenue Act of 1921. A life voting member pays \$500 on admission and is exempt from dues. The dues of a voting member are \$30 a year, payable in advance in three installments of \$10 each, payable January 1, May 1, and September 1, or February 1, June 1, and October 1, or March 1, July 1, and November 1, or April 1, August 1, and December 1, depending on the date on which the voting member was admitted to membership. If any installment is not paid on or before the 15th day of the month in which it is due a penalty of \$2 must also be paid. In this case each life voting member must pay (to the club, for the Government imposes on it the duty of collection) a tax of \$1 on May 1 and September 1, 1922, and on January 1, 1923, etc. If any one of these taxes is not paid to the club on or before the 15th day of the month in which it is payable, the tax will be \$1.20 instead of \$1. If it happens that an assessment of \$20, imposed for other than capital expenditures, in addition to the regular dues and payable November 15, 1922, is levied on the voting members, then a tax of \$2 from each life voting member must also be paid on that date to the club. If the \$500 life voting membership fee was paid before November 1, 1917, or on or after April 1, 1919, it is not itself taxable, but if paid on or after November 1, 1917, and before April 1, 1919, it is subject to a tax of \$50 under the Revenue Act of 1917.

**6874** (2) A certain golf club has two classes of members, life members and "members." A life member pays \$1,000 on admission and is exempt from dues. A "member's" dues are \$60 a year, a \$30 installment for January-June being payable April 1, and a \$30 installment for July-December being payable October 1. In the case of this club it is clear that a "member" is the "active resident annual member" specified in the Revenue Act of 1921. John Smith is elected a life member of this club in February, 1919, and in that month pays his \$1,000 fee and a tax of \$100 thereon, under the Revenue Act of 1917. Under the Revenue Acts of 1918 and 1921 he will have to pay (to the club, for the Government imposes on it the duty of collection) on April 1, 1919, a tax of \$1.50, and on October 1, 1919, April 1, 1920, etc., a tax of \$3—the same taxes as those Acts impose on a "member."

**6875** (3) A certain social club has three classes of members, life members, active members, and associate members. The regular dues of the active members (clearly the "active resident annual members" specified in the Revenue Act of 1921—see art. 9, above) are \$10 per year. Edwin Boyle became a life member in 1916, paying a fee of \$100. That payment was

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not taxable. Nor does he have to pay any annual tax under the Revenue Act of 1921. For by that Act he is to pay the same annual tax as "an active resident annual member," and as the regular dues of "an active resident annual member" are not in excess of \$10 per year, such a member pays no tax whatsoever. (See art. 9, above [¶6842].)

**6876** (4) A certain club the dues and fees of which are taxable has life members who do not avail themselves of the privileges of membership. Each of such life members must pay the tax imposed by section 801 of the Revenue Act of 1921 so long as he holds a life membership in the club.

**6877** (5) A certain social club the dues and fees of which are taxable passes a resolution providing that no membership dues or fees shall be collected from members who are in the military service of the United States. Such members thereafter pay no dues or fees and are therefore not liable for payment of tax with respect to membership in the club, but this does not relieve life members who are in the military service from payment of the tax on their life memberships.

**6878** **Art. 12. Duty to collect, return, and pay tax.**—Every club, organization, corporation, partnership, or individual receiving any taxable payment to for dues or fees, must at the time of such receipt, collect the tax from the person making such payment. And there rests on such person the corresponding duty of then paying such tax. Where the dues or membership fees are payable in periodical installments, the tax shall be collected as and when each installment is paid. In the case of assessments imposed for other than capital expenditures, the tax is due and shall be collected and paid when such assessments are paid. The tax on initiation fees is due and payable at the time of payment of such fees.

**6879** Every club or organization having life members taxable under the Revenue Act of 1921, must collect from such life members the tax imposed on them by that Act. And such life members must, on their part, promptly pay such tax. It shall be collected and paid "at the time for the payment of dues by active resident annual members." Thus, if the dues or membership fees of an active resident annual member, or if another designation is used, the member whose privileges correspond to those usually enjoyed by active resident annual members (see art. 9 [¶6842]), are payable in periodical installments the tax due from life members becomes due and shall be collected and paid as and when these installments are paid. If assessments imposed for other than capital expenditures are levied on active resident annual members, there shall be collected from live members at the time such assessments are paid a tax equivalent to 10 per cent of the amount so paid.

**6880** A monthly return and payment of all taxes collected must be made in accordance with the provisions of Article 13, below [¶6572]. (T. D. 3439, signed by Commissioner D. H. Blair, and dated February 12, 1923.)

**6881** **Changes effected by T. D. 3439, ¶6841 to 6880 above.**—The expression (see third line of ¶6534) "including recurrent assessments, assessments for running expenses" is changed (see third line of ¶6842) to "including all assessments except that portion thereof imposed for capital expenditures"; corresponding and related changes are made throughout. Example (15) in Art. 9, ¶6860, is new.—The Corporation Trust Company.



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(T. D. 3485.)

**6882** Time for filing returns and payment of taxes.—The sixth sentence  
 6572 of Article 41, Regulations 43, (Part 1); the fifth sentence of Article  
 6826 13, Regulations 43, (Part 2); the fourth sentence of Article 36, Regulations 47; the sixth sentence of Article 32, Regulations 48; the first sentence of Article 20, Regulations 52; and the second sentence of Article 35, Regulations 57, are hereby amended by inserting a comma at the end thereof, and adding the following: “except that when the last day of the month in which a return and payment are due falls on Sunday or a legal holiday, the return may be filed and payment made to the Collector of Internal Revenue or Deputy Collector on the next secular or business day.” (T. D. 3485, signed by Commissioner D. H. Blair, and dated June 1, 1923.)

(T. D. 3504.)

**6883** Time for registry under the provisions of Article 37, Regulations 43,  
 6817 Part 1, and Article 26 of Regulations 52, extended.—The first sentence of Article 37, Regulations 43, Part 1, (Revised January, 1922) previously amended by Treasury Decision 3394, is hereby further amended to read as follows:

“Application for and certificate of registry.—Every individual, corporation, partnership, or association (1) required by the provisions of the Act to collect any tax on admissions (see Art. 35) or (2) being the owner or lessee of any place which is ordinarily or at times leased to other persons who impose charges for admissions to it (see Art. 42) or (3) required to pay any tax on charges in excess of established price (see Art. 36) shall annually, on or before the *last*\* day of July, *or if that day fall on a Sunday or legal holiday, then on the next secular or business day*, or within ten days after commencing business, make an application for registry, by filling out Form 752 (Revised), with all information there called for, and duly execute it under oath.” (T. D. 3504, in part, signed by Acting Commissioner C. R. Nash, and dated August 4, 1923.)

\*Changes indicated by italics; application for registry was due, heretofore, on first day of July.—Later: Further amended by T. D. 3517, [¶6884].—The Corporation Trust Company.

(T. D. 3517.)

[Matter in *italics* is new; that enclosed in bold face brackets is superseded.]

**6884** Art. 37, Regulations 43, Part 1 amended.—Annual registration no longer required, etc.—Article 37, Regulations 43, Part 1, (Revised [6883] January, 1922) previously amended by Treasury Decisions 33<sup>c</sup> [6817] and 3504 [6883], is hereby further amended to read as follows:

**“Application for and certificate of registry.**—Every individual, corporation, partnership, or association (1) required by the provisions of the Act to collect any tax on admissions (see Art. 35) or (2) being the owner or lessee of any place which is ordinarily or at times leased to other persons who impose charges for admissions to it (see Art. 42) or (3) required to pay a tax on charges in excess of established price (see Art. 36) shall [annually] c or before July 31, 1922 [the last day of July, or if that day fall on a Sunday or legal holiday, then on the next secular or business day,] or within ten days after commencing business make an application for registry, by filling out Form 752 [Revised] with all information there called for, and duly execute it under oath; *Provided, That registration shall not be required of any such individual, corporation, partnership or organization required to file Form 11 and pay tax under section 1001, subdivision (5) of the Act* [7506].

**6885** “In cases falling within the first of the above classes (except such 6817 as are considered in Art. 38) such an application must be filed in the office of the collector of internal revenue of each district in which is located a place to which admissions are charged on account of which duty to collect admissions taxes is imposed on the person making such application. In cases falling within class (2) the application must be filed in the office of the collector of internal revenue of each district in which such a place is owned or leased. In cases falling within class (3) the application must be filed in the office of the collector of internal revenue of the district in which is located the principal place of business of the person making the application, or in which is located his residence, if he have no fixed place of business. The collector, if satisfied that all the statements made in the application for registry are correct, will issue a certificate of registry or Form 753 [(Revised)] to the person who made such application. The certificate must be kept conspicuously posted in the principal place of business of such person, or be carried about with him, if he has no fixed place of business. *This certificate is not transferable from one person or firm to another, or, except in the case of a traveling show, or similar organization, from one place of business to another.*

**6886** “EXAMPLE:—A certain hotel has a number of rooms which it 6818 rents from time to time for dances and other parties. This hotel falls within class (2) of Art. 37 and must [annually] make application for registry.” (T. D. 3517, in part, signed by Commissioner D. H. Blair, and dated September 17, 1923.)



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# SPECIAL TAXES.—1921 ACT.

BEING TITLE X OF THE REVENUE ACT OF 1921.

In effect July 1, 1922.

## TITLE X.—SPECIAL TAXES.

### [SPECIAL EXCISE TAX ON CORPORATIONS.]

**7500** Sec. 1000.—[For this law provision and the regulations thereunder see special section "Capital Stock Tax on Corporations" at ¶3000.]

### MISCELLANEOUS OCCUPATIONAL TAXES.

#### CALENDAR.

**Returns;** During July each year, or during the month of commencing business, or at the time of the original purchase of a new boat by a user, for the fiscal year ending June 30, next following.

**Tax;** During July each year, or during the month of commencing business, or at the time of buying a new boat.

The tax *should* be paid at the same time the return is filed. However, the 5% penalty does not accrue and the 1% interest does not begin to run until after ten days' notice and demand.

The specific penalty applies if the tax is not paid on or before July 31 or during the month of commencing business.

In the case of commencing business, or in the case of the purchase of a new boat by a user in any month other than July, the amount of tax to be paid is the same proportion of the amount provided by law for a full year as the number of months to the succeeding June 30, including the month of commencing business or of the purchase of the new boat, bears to twelve months.

**7501** Sec. 1001. That on and after July 1, 1922, there shall be levied collected, and paid annually the following special taxes—

#### [Brokers.]

**7502** (1) Brokers shall pay \$50. Every person whose business it is to negotiate purchases or sales of stocks, bonds, exchange, bullion, coined money, bank notes, promissory notes, other securities, produce or merchandise, for others, shall be regarded as a broker. If a broker is a member of a stock exchange, or if he is a member of any produce exchange, board of trade, or similar organization, where produce or merchandise is sold, he shall pay an additional amount as follows: If the average value, during the preceding year ending June 30, of a seat or membership in such exchange or organization was \$2,000 or more but not more than \$5,000, \$100; if such value was more than \$5,000, \$150.

#### [Pawn Brokers.]

**7503** (2) Pawn brokers shall pay \$100. Every person whose business or occupation it is to take or receive, by way of pledge, pawn, or exchange, any goods, wares, or merchandise, or any kind of personal property

whatever, as security for the repayment of money loaned thereon, shall be regarded as a pawnbroker.

[Ship Brokers.]

**7504** (3) Ship brokers shall pay \$50. Every person whose business it is as a broker to negotiate freights and other business for the owners of vessels or for the shippers or consignors or consignees of freight carried by vessels, shall be regarded as a ship broker.

[Custom House Brokers.]

**7505** (4) Custom house brokers shall pay \$50. Every person whose occupation it is, as the agent of others, to arrange entries and other custom house papers, or transact business at any port of entry relating to the importation or exportation of goods, wares, or merchandise, shall be regarded as a custom house broker.

[Theaters, Museums, and Concert Halls.]

**7506** (5) Proprietors of theaters, museums, and concert halls, where a charge for admission is made, having a seating capacity of not more than two hundred and fifty, shall pay \$50; having a seating capacity of more than two hundred and fifty and not exceeding five hundred, shall pay \$100; having a seating capacity exceeding five hundred and not exceeding eight hundred, shall pay \$150; having a seating capacity of more than eight hundred, shall pay \$200. Every edifice used for the purpose of dramatic or operatic or other representations, plays, or performances, for admission to which entrance money is received, not including halls or armories rented or used occasionally for concerts or theatrical representations, and not including edifices owned by religious, educational or charitable institutions, societies or organizations where all the proceeds from admissions inure exclusively to the benefit of such institutions, societies or organizations or exclusively to the benefit of persons in the military or naval forces of the United States, shall be regarded as a theater: *Provided*, That in cities, towns, or villages of five thousand inhabitants or less the amount of such payment shall be one-half of that above stated: *Provided further*, That whenever any such edifice is under lease at the time the tax is due, the tax shall be paid by the lessee, unless otherwise stipulated between the parties to the lease.

[Circuses.]

**7507** (6) The proprietor or proprietors of circuses shall pay \$100. Every building, space, tent, or area, where feats of horsemanship or acrobatic sports or theatrical performances not otherwise provided for in this section are exhibited shall be regarded as a circus: *Provided*, That no special tax paid in one State, Territory, or the District of Columbia, shall exempt exhibitions from the tax in another State, Territory, or the District of Columbia, and but one special tax shall be imposed for exhibitions within any one State, Territory, or District.



## [Other Public Exhibitions or Shows.]

**7508** (7) Proprietors or agents of all other public exhibitions or shows for money not enumerated in this section shall pay \$15: *Provided*, That a special tax paid in one State, Territory, or the District of Columbia shall not exempt exhibitions from the tax in another State, Territory, or the District of Columbia, and but one special tax shall be required for exhibitions within any one State, Territory, or the District of Columbia: *Provided further*, That this paragraph shall not apply to Chautauquas, lecture lyceums, agricultural or industrial fairs, or exhibitions held under the auspices of religious or charitable associations: *Provided further*, That an aggregation of entertainments, known as a street fair, shall not pay a larger tax than \$100 in any State, Territory, or in the District of Columbia.

## [Bowling Alleys and Billiard Rooms.]

**7509** (8) Proprietors of bowling alleys and billiard rooms shall pay \$10 for each alley or table. Every building or place where bowls are thrown or where games of billiards or pool are played, except in private homes, shall be regarded as a bowling alley or a billiard room, respectively.

## [Shooting Galleries.]

**7510** (9) Proprietors of shooting galleries shall pay \$20. Every building, space, tent, or area, where a charge is made for the discharge of firearms at any form of target shall be regarded as a shooting gallery.

## [Riding Academies.]

**7511** (10) Proprietors of riding academies shall pay \$100. Every building, space, tent, or area, where a charge is made for instruction in horsemanship or for facilities for the practice of horsemanship shall be regarded as a riding academy: *Provided*, That this tax shall not be collected from associations composed exclusively of members of units of the Federalized National Guard or the Organized Reserve and whose receipts are used exclusively for the benefit of such units.

## [Passenger Automobiles for Hire.]

**7512** (11) Persons carrying on the business of operating or renting passenger automobiles for hire shall pay \$10 for each such automobile having a seating capacity of more than two and not more than seven, and \$20 for each such automobile having a seating capacity of more than seven.

## [Brewers, Distillers, Liquor Dealers, etc.]

**7513** (12) Every person carrying on the business of a brewer, distiller, wholesale liquor dealer, retail liquor dealer, wholesale dealer in malt liquor, retail dealer in malt liquor, or manufacturer of stills, as defined in section 3244 as amended and section 3247 of the Revised Statutes, in any State, Territory, or District of the United States contrary to the laws of such State, Territory, or District, or in any place therein in which carrying on such business is prohibited by local or municipal law, shall pay, in addition to all other taxes, special or otherwise, imposed by existing law or by this Act, \$1,000.

**7514** The payment of the tax imposed by this subdivision shall not be held to exempt any person from any penalty or punishment provided for by the laws of any State, Territory, or District for carrying on such business in such State, Territory, or District, or in any manner to authorize the commencement or continuance of such business contrary to the laws of such State, Territory, or district, or in places prohibited by local or municipal law.

**[Taxes herein specified are in Lieu of the Similar Taxes  
Imposed by Section 1001 of the Revenue Act of 1918.]**

**7515** The taxes imposed by this section shall, in the case of persons upon whom a corresponding tax is imposed by section 1001 of the Revenue Act of 1918, be in lieu of such tax.

**Special Tobacco Manufacturers' Tax.**

**7516** **Sec. 1002.** That on and after July 1, 1922, there shall be levied, collected, and paid annually, in lieu of the taxes imposed by section 1002 of the Revenue Act of 1918, the following special taxes, the amount of such taxes to be computed on the basis of the sales for the preceding year ending June 30—

**7517** Manufacturers of tobacco whose annual sales do not exceed fifty thousand pounds shall each pay \$6;

**7518** Manufacturers of tobacco whose annual sales exceeded fifty thousand and do not exceed one hundred thousand pounds shall each pay \$12;

**7519** Manufacturers of tobacco whose annual sales exceed one hundred thousand and do not exceed two hundred thousand pounds shall each pay \$24;

**7520** Manufacturers of tobacco whose annual sales exceed two hundred thousand pounds shall each pay \$24, and at the rate of 16 cents per thousand pounds, or fraction thereof, in respect to the excess over two hundred thousand pounds;

**7521** Manufacturers of cigars whose annual sales do not exceed fifty thousand cigars shall each pay \$4;

**7522** Manufacturers of cigars whose annual sales exceed fifty thousand and do not exceed one hundred thousand cigars shall each pay \$6;

**7523** Manufacturers of cigars whose annual sales exceed one hundred thousand and do not exceed two hundred thousand cigars shall each pay \$12;

**7524** Manufacturers of cigars whose annual sales exceed two hundred thousand and do not exceed four hundred thousand cigars shall each pay \$24;

**7525** Manufacturers of cigars whose annual sales exceed four hundred thousand cigars shall each pay \$24, and at the rate of 10 cents per



thousand cigars, or fraction thereof, in respect to the excess over four hundred thousand cigars;

**7526** Manufacturers of cigarettes, including small cigars weighing not more than three pounds per thousand, shall each pay at the rate of 6 cents for every ten thousand cigarettes, or fraction thereof.

**7527** In arriving at the amount of special tax to be paid under this section, and in the levy and collection of such tax, each person engaged in the manufacture of more than one of the classes of articles specified in this section shall be considered and deemed a manufacturer of each class separately.

**7527a** In computing under this section the amount of annual sales no account shall be taken of tobacco, cigars, or cigarettes, sold for export and in due course so exported.

### Special Tax on Use of Boats.

**7528** **Sec. 1003.** That on and after July 1, 1922, and thereafter on July 1 in each year, and also at the time of the original purchase of a new boat by a user, if on any other date than July 1, there shall be levied, assessed, collected, and paid, in lieu of the tax imposed by section 1003 of the Revenue Act of 1918, upon the use of yachts, pleasure boats, power boats, sailing boats, and motor boats with fixed engines, of over five net tons and over thirty-two feet in length, not used exclusively for trade, fishing, or national defense, or not built according to plans and specifications approved by the Navy Department, a special excise tax to be based on each yacht or boat, at rates as follows: Yachts, pleasure boats, power boats, motor boats with fixed engines, and sailing boats, of over five net tons, length over thirty-two feet and not over fifty feet, \$1 for each foot; length over fifty feet, and not over one hundred feet, \$2 for each foot; length over one hundred feet, \$4 for each foot.

**7529** In determining the length of such yachts, pleasure boats, power boats, motor boats with fixed engines, and sailing boats, the measurement of over-all length shall govern.

**7530** In the case of a tax imposed at the time of the original purchase of a new boat on any other date than July 1, the amount to be paid shall be the same number of twelfths of the amount of the tax as the number of calendar months (including the month of sale) remaining prior to the following July 1.

**7531-3** This section shall not apply to vessels or boats used without profit by any benevolent, charitable, or religious organizations, exclusively for furnishing aid, comfort, or relief to seamen.

### Penalty for Nonpayment of Special Taxes.

**7534** **Sec. 1004.** That any person who carries on any business or occupation for which a special tax is imposed by sections 1000, 1001 or 1002, without having paid the special tax therein provided, shall, besides being liable for the payment of such special tax, be subject to a penalty of not more than \$1,000 or to imprisonment for not more than one year, or both.

**7535-6** [General Administrative Law Provisions.]  
[Read at "Miscellaneous Matters" at back of the book.]

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## SPECIAL TAXES ON OCCUPATIONS REGULATIONS.

TREASURY DEPARTMENT  
U. S. INTERNAL REVENUE SERVICE  
Form 11—Revised Jan., 1923

# SPECIAL-TAX RETURN

(SEE INSTRUCTIONS ON BACK)

(Stamp number.)

Name

(Give name of taxpayer to be followed by trade name if desired.)

(Date of issue.)

Address

(Number of building, street, or other exact location.)

(City or town.)

(County.)

(State.)

(Entered in record 10.)

Business

(Kind of business to be covered by stamp—See proper designation on back of this form.)

to June 30, 192

If proprietors or agents of public exhibitions, an aggregation of entertainments (see reverse side), state number of shows.

Number

If proprietor of theater, museum, or concert hall, capacity seating and give population of city or town in which located.

Population.

If proprietor of bowling alleys and billiard rooms, state total number of alleys and tables.

Tables.

Alleys.

If manufacturer of tobacco, cigars, or cigarettes, state total quantity sold during previous fiscal year.

Quantity

Give below name and residence of each person interested in the business. If a corporation, give name, residence, and title of each officer.

NAME.

RESIDENCE.

Sworn to and subscribed before me this

day of \_\_\_\_\_, 192

I swear (or affirm or acknowledge) that the above statements are true and correct and the special-tax stamp herein applied for is to cover only the business indicated above and at the location specified.

Cash:

Draft:

(Signed)

(Official title or signature of witnesses.)

Check:

M. O.:

Received by Collector

Make remittance payable to "Collector of Internal Revenue." Enter amount in proper space.

(State whether individual owner, member of firm, or if officer of corporation, give title.)

This return, properly executed, should be forwarded to the Collector of Internal Revenue at \_\_\_\_\_ with the amount of the tax, in the month in which liability is incurred. Checks must be certified.

2-8768

## SPECIAL TAXES ON OCCUPATIONS REGULATIONS.

## LIST OF SPECIAL-TAX PAYERS

Monthly and annual rates to June 30.		Monthly and annual rates to June 30.	
Monthly.	Annual.	Monthly.	Annual.
*Brewers of less than 500 barrels.....	\$4.16‡	‡Proprietors of theaters, museums, or concert halls (Continued):	
*Brewers of 500 barrels or more.....	8.33‡	Seating capacity over 500 but not over 800.....	\$150.00
Rectifiers of less than 500 barrels.....	8.33‡	Seating capacity over 800.....	200.00
Rectifiers of 500 barrels or more.....	16.66‡	‡Proprietors of circuses.....	8.33‡
*Retail liquor dealers.....	25.00‡	‡Proprietors or agents of public exhibitions (not otherwise enumerated).....	1.25
*Wholesale liquor dealers.....	8.33‡	‡Proprietors of entertainments or street fair—maximum tax.	100.00
*Retail malt liquor dealers.....	1.66‡	Proprietors of bowling alleys and billiard rooms—for each alley or table.....	8.33‡
*Wholesale malt liquor dealers.....	4.16‡	Proprietors of shooting galleries.....	10.00
Manufacturers of oleomargarine.....	50.00	Proprietors of riding academies.....	1.66‡
Retail dealers—uncolored oleomargarine.....	6.00	‡Manufacturers of tobacco:	8.33‡
Wholesale dealers—uncolored oleomargarine.....	16.66‡	Annual sales not over 50,000 lbs.....	.50
Retail dealers—colored oleomargarine.....	4.00	Annual sales over 50,000 but not over 100,000 lbs.....	12.00
Wholesale dealers—colored oleomargarine.....	40.00	Annual sales over 100,000 but not over 200,000 lbs.....	2.00
Manufacturers of adulterated butter.....	50.00	Annual sales over 200,000 lbs.....	21.00
Retail dealers—adulterated butter.....	4.00	and in respect to each 1,000 lbs. or fraction thereof in excess of 200,000 lbs.....	.16
Wholesale dealers—adulterated butter.....	40.00	‡Manufacturers of cigars:	
Manufacturers—process or renovated butter.....	4.16‡	Annual sales not over 50,000 cigars.....	4.00
Manufacturers—filled cheese.....	33.33‡	Annual sales over 50,000 but not over 100,000 cigars.....	.50
Retail dealers—filled cheese.....	1.00	Annual sales over 100,000 but not over 200,000 cigars.....	12.00
Wholesale dealers—filled cheese.....	20.83‡	Annual sales over 200,000 but not over 400,000 cigars.....	2.00
Manufacturers of mixed flour.....	1.00	Annual sales over 400,000 cigars.....	21.00
Manufacturers of stills and worms.....	4.16‡	and in respect to each 1,000 cigars or fraction thereof in excess of 400,000 cigars.....	.10
Stills manufactured—for each still.....	4.16‡	‡Manufacturers of cigarettes—for each 10,000 cigarettes or fraction thereof. (This includes small cigars weighing not more than 3 lbs. per 1,000.).....	.00‡
Worms manufactured—for each worm.....	8.33‡		.05
Shoebrokers (Return made on Form 11-A).....	4.16‡		
Customhouse brokers (Return made on Form 11-A).....	4.16‡		
‡Proprietors of theaters, museums, or concert halls:			
Seating capacity not over 250.....	4.16‡		
Seating capacity over 250 but not over 500.....	8.33‡		

## INSTRUCTIONS

Special-tax liability is reckoned from the first of July of each year or the first day of the month during which business is commenced to the thirtieth day of June following. Where business is begun after the month of July the tax to be remitted is computed by multiplying the monthly rate stated above by the number of months remaining in the fiscal year and if the amount resulting involves a fraction the full cent must be included. For example, a pawnbroker begins business during September:  $\$8.33\frac{1}{2}$  is multiplied by 10, which equals  $\$83.34$  or  $\$83.34$  to be remitted.

If application on this Form is not filed with the Collector during the month in which the liability began a 25 per cent penalty is incurred. Applicant must appear in person before an officer qualified to administer oaths and "swear" to the correctness of the information given on the application. If the amount of tax covered by this return is not in excess of \$10, the return may be signed or acknowledged before two witnesses instead of under oath.

On the first line must be entered the name of the actual owner or owners of the business which may be followed by a "trade name" if desired, but no application will be accepted nor special-tax stamp issued in a trade name only. File promptly, follow instructions carefully, and thus avoid delays.

\* If business is carried on contrary to the laws of the State, Territory, or District of the United States, or in any place where prohibited by local or municipal law, in addition to all other taxes, special or otherwise; monthly  $\$83.33\frac{1}{2}$ ; annual \$1,000 shall be paid.

‡ In the case of theaters, museums, or concert halls, in cities, towns, or villages of 5,000 inhabitants or less, the amount of tax shall be one-half of that stated above.

‡ This tax is payable for exhibitors in each State, Territory, or District of Columbia.

‡ The tax in these cases is to be computed on the basis of sales for the preceding year, to be reported on reverse side.



TREASURY DEPARTMENT  
UNITED STATES INTERNAL REVENUE  
Form 11-A—Revised Jan., 1922

**BROKERS'**  
**SPECIAL-TAX RETURN**  
(SEE INSTRUCTIONS ON BACK)

Name \_\_\_\_\_ (Stamp number.) \_\_\_\_\_  
Address \_\_\_\_\_ (Name of taxpayer—to be followed by trade name if desired.) \_\_\_\_\_  
(Number of building, street, or other exact location.) \_\_\_\_\_ (City or town.) \_\_\_\_\_ (State.) \_\_\_\_\_  
Character of business \_\_\_\_\_ (County.) \_\_\_\_\_  
(Broker, Pawnbroker, Ship Broker, etc.) \_\_\_\_\_, Period \_\_\_\_\_ to June 30, 19\_\_\_\_  
(Entered in Record 10.) \_\_\_\_\_

Give below name and residence of each person interested in the business. If a corporation, give name, residence, and title of each officer.

NAME.	RESIDENCE.
_____	_____
_____	_____
_____	_____
_____	_____

Give below name of each Stock Exchange, Produce Exchange, Board of Trade, or similar organization in which seat or membership is held, and average value during preceding year of a single seat in each such organization.

NAME OF EXCHANGE. (If additional space is required use reverse side of card.)		AVERAGE VALUE OF SINGLE SEAT DURING PRECEDING YEAR.
-----		\$-----
-----		\$-----
-----		\$-----
-----		\$-----

Sworn to and subscribed before me this \_\_\_\_\_ day of \_\_\_\_\_, 19\_\_\_\_

Cash:	Draft:	
Check:	M. O.:	

(Signed)

(Official title or signature of witnesses.)

Received by Collector \_\_\_\_\_

Make "emittance payable to "Collector of Internal Revenue."

This return, properly executed, with the amount of the tax due, should be forwarded to the Collector of Internal Revenue at \_\_\_\_\_

(State whether individual owner, member of firm, or if officer of corporation, give title.)





## SPECIAL TAXES ON OCCUPATIONS REGULATIONS.

TREASURY DEPARTMENT  
INTERNAL REVENUE SERVICE  
Form 792—Revised April, 1923

# SPECIAL-TAX RETURN AUTOMOBILES FOR HIRE OR USE OF BOATS

(See instructions on back.)

NAME \_\_\_\_\_  
(Give name of taxpayer, to be followed by trade name if desired.)

ADDRESS \_\_\_\_\_  
(Number of building, or street, or other exact location.) (City or town.) (County.) (State.)

SPECIAL TAX ON \_\_\_\_\_  
(State whether automobile or boat.) FOR PERIOD FROM \_\_\_\_\_ TO JUNE 30, 19 \_\_\_\_\_  
(Entered on record to.)

(Stamp number.)  
(Date of issue.)

## AUTOMOBILES

(A separate return is required for each automobile or boat.)

## BOATS

If in the business of operating or renting passenger automobiles for hire, give make, model, engine number, and seating capacity of such automobile in proper spaces provided below:

MAKE \_\_\_\_\_ MODEL \_\_\_\_\_

ENGINE NUMBER \_\_\_\_\_ SEATING CAPACITY \_\_\_\_\_

1. Name of boat \_\_\_\_\_ Kind of boat \_\_\_\_\_

2. If boat is registered by Navigation Bureau, give Reg. No. \_\_\_\_\_

3. What is length of boat over all? \_\_\_\_\_ Net tonnage? \_\_\_\_\_

Give below name and residence of each person interested in the business. If a corporation, give name, residence, and title of each officer.

NAME

RESIDENCE

Sworn to and subscribed before me this \_\_\_\_\_ day of \_\_\_\_\_, 1923

I swear (affirm or acknowledge) that the above statements are true and correct and the special-tax stamp herein applied for is to cover only the business or boat indicated above.

*Cash _____	Dollars	Cents
*Certified Check _____		
*Post-office M. O. _____		

\*Cross out form of payment NOT used.  
Make remittance payable to "Collector of Internal Revenue." Enter amount in above space.

(State whether individual owner, lessee, member of firm, or if officer of corporation give title.)

This return, properly executed, should be forwarded to the Collector of Internal Revenue at \_\_\_\_\_ with the amount of the tax, within the month in which the liability is incurred.

## SPECIAL TAXES ON OCCUPATIONS REGULATIONS.

## INSTRUCTIONS

## PLEASURE BOATS

1. **WHAT IS TAXED.**—Subject to exemptions noted hereunder, a special tax is imposed upon the use of yachts, pleasure boats, power boats, motor boats with fixed engines, and sailing boats, of over five net tons, length over 32 feet, at the following rates:

- (a) Over five net tons, length over 32 feet and not over 50 feet.....\$1.00 each foot
- (b) Over five net tons, length over 50 feet and not over 100 feet.....\$2.00 each foot
- (c) Over five net tons, length over 100 feet.....\$4.00 each foot

2. **EXEMPTIONS.**—The law exempts from tax—

- (a) Boats used *exclusively* for trade. ("Trade" is held to be any serious activity which constitutes the means of livelihood of the owner, lessee, or charterer.)
- (b) Boats used *exclusively* for fishing. (This refers to commercial fishing and not fishing for pleasure.)
- (c) Boats used *exclusively* for national defense.
- (d) Boats built according to plans and specifications approved by the Navy Department.
- (e) Boats used without profit by benevolent, charitable, or religious organizations *exclusively* for furnishing aid, comfort, or relief to seamen.

3. **PERSONS LIABLE FOR RETURN AND PAYMENT OF TAX.**—The owner, lessee, or charterer of every boat described in par. 1 is required to file return and pay the required tax, unless the boat is exempt under par. 2. No return is required on boats specifically exempt or those falling below the tonnage and footage specifications mentioned in par. 1.

4. **HOW TO ESTIMATE NET TONNAGE.**—To estimate roughly the net tonnage of a vessel the following rules may be used:

- (a) By the word "ton" is meant 100 cubic feet of space.
- (b) Multiply the extreme length of the vessel by the extreme breadth and that product by the depth from the underside of the deck to the frame in the hold taken amidships. The result obtained should be multiplied by six-tenths. To this result should be added the cubical contents of any closed-in structure above the upper deck. The sum should be divided by 100, which will give the approximate gross tonnage of the boat.
- (c) From this gross tonnage may be deducted all spaces used *exclusively* in connection with the navigation of the boat or for the exclusive use of the crew, such as a reasonable amount for machinery space, space for officers and crew but not for passengers (who include all persons not actual members of the crew), storage of sails, navigation instruments, boatswain's stores, etc. The result will be the approximate net tonnage of the boat.
- (d) If the net tonnage estimated is more than four net tons, and the length over 32 feet, application should be made to the nearest customs officer for official measurement. If an official measurement is not completed before the date on which a return is required, a return should be rendered; and if the estimate of net tonnage, made as above directed, is over five net tons, the tax should be paid. If the official measurement should later show that no tax was due, a claim should be made for the refund of the tax.

5. **HOW TO ASCERTAIN THE OVER-ALL LENGTH.**—Over-all length is defined as the extreme length of the structure, i. e., from the forward side of the stem outside the planking or plating to the aftermost side of the stern planking or plating, whether above or below the water line. The measurement should be to the outside of any planking or plating extending above the deck, constituting bulwarks, and to the outside of any forecask deck, quarter deck, or poop deck extending beyond the main deck. The length should be taken in a straight line, excluding any sheer there may be to the deck.

6. **HOW TO COMPUTE TAX.**—In the case of a boat over five net tons, multiply the rate of the class in which the boat is included by the number representing the length over all in full feet. For example, a boat 49.5 feet in length is taxable at the rate of \$1 for each foot, or \$49; a boat 50.5 feet in length is in the same class and taxable at \$1 per foot, or \$50.

## AUTOMOBILES

7. **PERSONS LIABLE FOR RETURN AND PAYMENT OF TAX.**—Persons carrying on the business of operating or renting passenger automobiles for hire are required to file return and pay special tax on each automobile as follows:

	Annual rate.	Monthly rate.
Seating capacity over 2 but not over 7.....	\$10	\$0.83
Seating capacity more than 7.....	\$20	\$1.66

## GENERAL

8. **WHEN RETURN AND PAYMENT OF TAX MUST BE MADE.**—These taxes become due on the first day of July in each year, or on commencing the business on which a tax is imposed or placing a boat in use. In the former case the tax shall be reckoned for one year and in the latter case it shall be reckoned proportionately from the first day of the month in which the liability to special tax commenced to the first day of July following. Returns with proper amount of tax due must be filed with the collector not later than the last day of the month in which special tax liability commenced. A separate return must be filed for each automobile operated or rented for hire, and for each boat.

9. If tax liability, as shown by the return, is more than \$10, applicant must appear in person before an officer qualified to administer oaths and swear to the correctness of the information given on the application. If the tax is \$10 or less, return may be signed or acknowledged before two witnesses, who will affix their signatures.

Follow instructions carefully and file promptly in order to avoid penalties imposed for delinquency in filing return and paying tax, or making false or fraudulent return.

c2—12636

GOVERNMENT PRINTING OFFICE



## SPECIAL TAXES ON OCCUPATIONS REGULATIONS.

## REGULATIONS 59.

[Approved July 20, 1922.]

[T. D. 3382.]

[Compiled with certain supplementary matters, as cited.]

Relating to the

SPECIAL TAXES UPON BUSINESSES AND OCCUPATIONS

and upon

THE USE OF BOATS

under

SECTIONS 1001 (SUBDIVISIONS (1) TO (11) INCLUSIVE)

AND 1003 OF THE REVENUE ACT OF 1921

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WAR TAX 1513 SERVICE

## SPECIAL TAXES ON OCCUPATIONS REGULATIONS.

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**7537 Art. 1. Scope of regulations.**—These regulations relate to the  
**7501** special taxes upon businesses and occupations, imposed by subdivisions (1) to (11), inclusive, of section 1001, and upon the use of boats, imposed by section 1003, of the Revenue Act of 1921.

## SPECIAL TAXES UPON BUSINESSES AND OCCUPATIONS.

**7538 Art. 2. Effective date.**—The effective date of the special tax on occupations enumerated in section 1001 of the act is July 1, 1922.

**7539 Art. 3. Use of terms.**—In these regulations—for convenience unless obviously inapplicable—

**7540** The term "person" shall include partnerships, corporations, and associations as well as individuals;

**7541** The term "secondary tax" shall mean the tax imposed on brokers by reason of their ownership of a membership or seat, valued at \$2,000 or more, in a stock or produce exchange, board of trade, or similar organization;

**7542** The term "fiscal year" shall mean the period from July 1 of each calendar year to June 30, inclusive of the following calendar year.

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## SPECIAL TAXES ON OCCUPATIONS REGULATIONS.

**7543 Art. 4. Basis of tax.**—The tax is upon the engaging in or carrying on of a business or occupation. If a person does not engage in or carry on any of the businesses or occupations specified in section 1001 during the taxable period, no special tax liability is incurred. If, however, he does carry on a business upon which a tax is imposed during any portion of the taxable year, he is liable to tax from the first of the month during which he begins business to the end of the taxable period. (See sec. 3237, R. S., as amended by sec. 53, act of Oct. 1, 1890 [26 Stat., 567].)

**BROKERS.**

[See beginning at ¶3720.]

**7544 Art. 5. Brokers: Persons liable.**—Only those persons who have a  
 3720 business of their own as distinguished from that of their employer or  
 7502 employers are liable to special tax as brokers. Any person who holds himself out as a broker and is engaged in the business of negotiating purchases or sales of any of the articles enumerated is liable to tax. It is not necessary that the brokerage business shall be the sole business of a person in order that liability to tax shall attach. Any person who, in connection with his profession or occupation, makes it a regular part of his business to negotiate purchases or sales for others of articles enumerated is liable to tax. Mere casual or incidental negotiation of purchases or sales for others of articles enumerated does not constitute a business for the purpose of the tax. The following among others are subject to special tax as brokers:

**7545 (a)** A bucket-shop proprietor giving memoranda of transactions to customers. By a “bucket-shop” is meant a place, other than a board of trade or exchange, where the parties who agree to buy and sell stocks do not ordinarily contemplate the receiving or delivering of any certificates therefor by the buyer or seller either at the time or in the future;

**7546 (b)** A bank which sells checks drawn by any person or concern in which it has no property interest, if such transactions are engaged in with such frequency or in such a way as to constitute a business;

**7547 (c)** An agent occupying an independent status and not that of an employee who negotiates the sale of foreign money orders for a steamship company; the fact that he maintains a place where the money orders are issued is evidence of an independent status;

**7548 (d)** A person who, under an agreement previously made with dealers, engages in the business of issuing orders upon those dealers for certain articles or commodities to parties who desire to purchase such articles or commodities;

**7549 (e)** One who holds himself out as dealing in exchange and in the regular course of business accepts orders and takes them to a bank for execution by the latter, receiving substantial remuneration for his services;

**7550 (f)** An express company engaged in the business of buying or selling foreign money orders or bills of exchange for others;

**7551 (g)** A real estate or business broker who lists and negotiates purchases or sales of produce or merchandise independently of purchases or sales of real estate or businesses, or holds himself out as being engaged in the business of negotiating, for others, purchases or sales of produce or merchandise;

**7552 (h)** A commission merchant receiving produce or merchandise on consignment to sell for the account of the consignors;

## SPECIAL TAXES ON OCCUPATIONS REGULATIONS.

**7553** (i) A dealer in securities of a given kind for the account of an underwriter or other broker;

**7554** (j) An auctioneer who maintains auction rooms or other place of business to which produce or merchandise is sent to be sold for the account of the consignor;

**7555** (k) A factor who advances money to farmers on crops which are to be placed with him to be sold on commission.

**7556** (l) A tobacco warehouseman whose business it is to arrange that tobacco growers shall bring their produce to the warehouse to be sold at auction and that tobacco buyers shall attend such auction sales and bid for the tobacco. [4th C. C. of A., in *Cothran & Connally vs. U. S.*, so held, Oct. 21, 1922.—1922 War Tax Service, ¶7667. (T. D. 3413.)]

**7557 Auctioneers as brokers.**—Reference is made to an inquiry received in this office in regard to the applicability of tax under section 1001, paragraph (1), of the Revenue Act of 1918, on brokers. You are advised that this office confirms its previous ruling as follows:

“Auctioneers making sales on a farm or premises of the owner of goods are not subject to the broker’s tax for the reason that they are only agents of their employers. An auctioneer, however, who has auction rooms, or other places of business, to which persons send goods or merchandise to be sold, is held to be carrying on a brokerage business and is amenable to the special tax under section 1001 of the Revenue Act of 1918.” [Applies to 1921 Act as well. See ¶7580c.]

**7558** A distinction is made between an auctioneer who has a place of business of his own and occupies an independent status, and an agent of another negotiating the sale of goods at another’s place of business. (Letter to The Corporation Trust Company, signed by Deputy Commissioner James M. Baker, and dated July 28, 1920.)

**7559 Art. 6. Persons not liable.**—The following persons are not subject to special tax as brokers where the business mentioned herein is the only business conducted by such persons. If, however, coupled with a business mentioned in this article any such person engages in any of the occupations mentioned in Article 5, or other brokerage transactions, to such an extent as to constitute a business, such person must pay the tax, although at the same time he engages in other occupations, not in themselves such as to subject such person to liability for special tax as a broker:

**7560** (a) Any persons who only occasionally or incidentally engages in brokerage transactions;

**7561** (b) A person loaning money for himself or for others, on commission;

**7562** (c) A bank which does not engage in the negotiating of purchases or sales of stocks or bonds as a business, but merely negotiates the purchase and sale thereof for depositors and other patrons without remuneration and for their accommodation only;

**7563** (d) A bank which sells its own drafts upon the foreign correspondent of another institution, if it has at the time of the drawing of such drafts credit with such correspondent, or if the drafts are drawn on credit which it is the intent to obtain. Such a bank acts as a principal and not as a broker. A bank which sells drafts or orders drawn by others, if the drafts or orders are sold by the bank as its own property, whether or not it paid cash for them or obtained them under a credit arrangement, likewise acts as a principal and not as a broker;



## SPECIAL TAXES ON OCCUPATIONS REGULATIONS.

- 7564** (e) A bank which effects a financial arrangement to carry out the terms of a sale where the purchaser and seller of merchandise have previously agreed upon the kind and quantity of the merchandise to be sold and upon the terms of the sale;
- 7565** (f) A person selling securities which he has purchased prior to the sale thereof and which he sells for his own account;
- 7566** (g) A person dealing in oil leases only;
- 7567** (h) A person holding a seat in a stock exchange but transacting no business for others;
- 7568** (i) A person negotiating purchases and sales of real estate;
- 7569** (j) A person who receives and negotiates the transmission of money abroad where there are neither purchases nor sales of any money orders, drafts, bills of exchange, or any other instruments constituting exchange;
- 7570** (k) A person negotiating loans and requiring the borrowers to pay a commission to the person securing the loan, drawing papers, or examining titles;
- 7571** (l) A railway agent who exchanges foreign money for American money and vice versa, merely in the transaction of the freight and passenger business of his company;
- 7572** (m) A loan and mortgage company which loans its own funds upon notes or bonds secured by mortgage or trust deed of real estate and which subsequently sells such notes or bonds so taken, on its own account and for its own profit or loss;
- 7573** (n) A person employed by a coal company, as agent to negotiate sales of coal for the company on a commission basis;
- 7574** (o) A traveling or other salesman who has no business of his own but is an employee of the firm or firms which he represents;
- 7575** (p) A person who buys or sells Liberty bonds or other securities for himself, purchasing them with his own money, title to the securities actually passing to or being in such person;
- 7576** (q) A person engaged in the business of placing loans secured by notes and mortgages upon real estate, acting only as agent and receiving a commission for his services;
- 7577** (r) An agent of a mill or factory who is in fact a part of the sales department of such mill or factory, and performs such services as selling the goods, determining what fabrics or products the mill or factory can best make, designing fabrics, indorsing notes of the mill or factory, and otherwise financing the mill or factory, or providing expert advice to it.
- 7578** (s) A person having territorial rights for the sale of articles placed in his possession, when sold in his own name;
- 7579** (t) A corporation selling its own stock through its own employees who are acting under its exclusive supervision and control;
- 7580** (u) A person engaged in the business of buying and selling tickets;
- 7580a** (v) Live stock brokers and live stock commission merchants.
- 7580b** (w) A person negotiating purchases or sales of businesses;
- 7580c** (x) An auctioneer who makes sales of produce or merchandise on the farm or premises of the owner.

**7581 Art. 7. Secondary tax.**—A broker who owns seats in different exchanges is liable to the secondary tax upon the value of a seat (valued at \$2,000 or more) in each exchange. A broker who owns a number of

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seats in the same exchange is liable to the secondary tax upon only the value of a single seat. A partnership or corporation doing a brokerage business is liable to both the primary and secondary tax to the same extent as an individual. It is immaterial that the seat in the exchange through which the partnership transacts business is held in the name of an individual. Where two or more members of a partnership doing a brokerage business own seats in the same exchange and all the business transacted by such partners is for the partnership, the partnership is liable to the secondary tax upon the value of only a single seat in the exchange. Where all the trading done by the members of a firm or partnership is for the firm or partnership but one payment of special tax is required. If, however, at any time purchases or sales of securities are made for others upon a commission basis by any member of the firm or partnership for his own account and not for the account of the firm or partnership special tax liability is incurred by the individual; secondary tax liability is also incurred provided the individual owns a membership or seat (valued at \$2,000 or more) in a stock or produce exchange, board of trade, or similar organization. For example, A, B, and C, members of a partnership, each own a membership in the same exchange; but one special tax and one secondary tax are due so long as all the trading is done for the partnership; but if any one of the members accepts individual commissions then such member is individually liable to special tax and secondary tax in addition to the tax imposed on the partnership. Where the possession of a share of stock is a prerequisite to membership in a stock exchange a lessee of a share of stock in such exchange actually carrying on a brokerage business is liable to the secondary tax and not the lessor of the share. The secondary tax on a membership in a stock or produce exchange should be paid in the district where special tax as a broker is paid; for example, a broker in Boston is a member of the New York Stock Exchange and subject to secondary tax by reason of such membership. Such secondary tax should be paid to the collector of the district in which Boston is located and not to the collector of the district in which the New York Stock Exchange is located, unless such broker maintains a branch office in New York and pays special tax therefor.

**7582 Art. 8. Branch offices.**—Inasmuch as the payment of one special tax cannot cover the doing of business by a broker in branch offices, a broker who maintains such branch offices is required to pay a special tax in respect of the main office and of each branch office where a brokerage business is conducted. The special tax is not required in the case of a branch office similar to the smaller offices frequently located in hotels, where the duties of the clerks employed are restricted to the taking of orders and their transmission to the main office without transacting any other business. The special tax must be paid, however, with respect to branch offices or brokers that are equipped to do and who actually do a brokerage business. A branch office, organized for the transaction of business, which receives orders, disburses funds and renders statements to its customers, must pay the special tax provided. The distinction to be drawn is whether a brokerage business is transacted at the branch office. It is considered that business is so transacted unless the activities of the branch house are restricted to the receipt of orders and money for transmission to the parent house and to the disbursement of such funds only as are received from the parent house with specific, detailed instructions as to their disposition.



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## PAWNBROKERS.

**7583 Art. 9. Pawnbrokers: Delivery.**—Delivery of personal property as  
 7503 security for the repayment of money loaned thereon is necessary to incur liability to special tax as a pawnbroker. By agreement of the parties the pledge may be deposited in the hands of a third person instead of being delivered to the pawnbroker.

**7584 Art. 10. Persons liable.**—The following, among others, are liable to tax as pawnbrokers:

**7585 (a)** A person using no tickets in his business, but making a pretense of buying articles which are brought to him which he holds under a verbal agreement that the articles can be bought back again by the person selling them upon the payment of a specified bonus;

**7586 (b)** A concern though called a bank which has practically no deposits and almost its entire business is the loaning of money on automobiles secured by warehouse receipts.

**7587 Art. 11. Persons not liable.**—A person is not required to pay a special tax as a pawnbroker for occasional or incidental acts which can not be regarded as constituting his business or occupation. Banks doing a bona fide banking business are not required to pay tax as pawnbrokers in cases where they accept diamonds or jewelry or other personal property as collateral security for the making or extension of loans if such loans are made on the same conditions and at the same rate of interest as other loans, provided such loans comprise the smaller portion of the loan business of the bank. Bankers who are able to show that they did not invite or cater to persons desiring to borrow money on articles of personal property, but merely made such loans upon request of and to oblige persons doing other business with them or who have taken such property as security only to save themselves from loss in connection with loans previously made are not liable to the special tax. The special tax on pawnbrokers is not required to be paid for making loans on chattel mortgages or in any case where chattels or personal property are not taken or received by way of pledge, pawn, or exchange.

## SHIP BROKERS.

**7588 Art. 12. Ship brokers: Persons liable.**—Persons engaged in the  
 7504 business of negotiating freights and business of a similar kind and character for the owners of vessels or for the shippers or consignors or consignees of freight carried by vessels are subject to tax as ship brokers. Liability to tax is not incurred unless the work performed is of the same general character as the negotiation of freights. Persons acting as agents for ship owners in finding charterers for their ships or as agents for charterers in finding ships available for charter are ship brokers. A person whose business it is to furnish sailors on a commission basis or for a flat rate for each sailor furnished is not a ship broker. An express company which undertakes for a lump sum to deliver freight at some foreign port and makes arrangement with various railroad and steamship lines on its own account and not as the agent of the shippers for the transportation of such freight is not a ship broker. A person who as an agent of the consignee attends to the proper

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forwarding of goods consigned to domestic or foreign ports, sees that proper inspection is made and manifests issued is not a ship broker, but a customhouse broker. A person performing both the duties of a ship broker and a customhouse broker is subject to the special tax of both a ship broker and a customhouse broker.

## CUSTOMHOUSE BROKERS

**7589 Art. 13. Customhouse brokers: Persons liable.**—A person or firm  
**7505** holding himself or itself out to the public as engaged in the occupation of customhouse broker either by maintaining an office or sending out literature or advertising matter is required to pay special tax as a customhouse broker. If the business of such a person is transacted by employees at offices at different ports, a separate and distinct special tax must be paid for each office. A special tax stamp taken out by a person in his own name as a customhouse broker is sufficient to cover the business done by him in his own name at the place of business stated therein whether such business is done by him on his own account or as an agent for other persons. Persons whose occupation it is as agents of others to enter and clear vessels in the customhouse are not relieved from special tax as customhouse brokers on the ground that they have paid special tax as ship brokers. A railroad or other corporation operated by the United States and acting as the agent of others to arrange entries and other customhouse papers acts in a governmental capacity and is not liable to tax.

## THEATERS, MUSEUMS, AND CONCERT HALLS.

**7590 Art. 14. Theaters, museums, and concert halls: Persons liable.**—  
**7506** The tax is upon the business of operating a theater, museum, or concert hall where a charge for admission is made. A person owning a theater which is not used at any time during the taxable year is not liable to tax. A "proprietor" of a theater, museum, or concert hall is the owner of such a building, or the lessee or tenant if the building is leased or rented. The owner is liable for the special tax unless the building is under lease at the time the tax is due, in which case the tax shall be paid by the lessee unless otherwise stipulated between the parties to the lease. (See art. 20.) The tax is upon each theater operated by the proprietor. If the same proprietor has theaters in different internal-revenue districts, the tax due upon each theater must be paid in the district in which such theater is located.

**7591 Art. 15. "Charge for admission."**—By a "charge or admission" is meant a charge for the right or privilege to enter or remain in a theater, museum, or concert hall for a limited time. No liability to tax is incurred by a proprietor on account of the giving of moving picture exhibitions or concerts where no admission fee is charged and only collections are taken up, persons in the audience contributing if they see fit.

**7592 Art. 16. Theater defined.**—Only an "edifice" (a building or structure of a permanent character) used for the purpose of dramatic or operatic or other representations, plays, or performances for admission to which entrance money is received is to be regarded as a theater. A railroad car or a boat fitted up as a theater and traveling about from place to place is to be regarded as an edifice. An open-air theater with a permanent roof



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over the audience or the stage is an edifice, but an airdome or tent is not. Where the proprietor of a theater operates a theater at one location and an airdome at another location he is subject to tax under this subdivision with respect to the operation of the theater and under subdivision (7) upon the operation of the airdome. Where an airdome is operated in connection with a theater, the same ticket admitting a patron to either the theater or airdome, a special tax stamp under this subdivision is required for the theatre and one under subdivision (7) for the airdome.

**7593 Art. 17. Exemptions.**—(a). Halls or armories rented occasionally for the purpose of dramatic or operatic or other representations, plays, or performances for admission to which a charge is made are exempt from tax. Liability to tax is not determined by the average number of times per month that such hall or armory may be rented for dramatic representations, but upon the primary usage of the hall or armory for such representations. The proprietor of an exhibition or show for money renting the hall or armory is liable to tax under subdivision (7).

**7593a (b).** Edifices owned by religious, educational or charitable institutions, societies or organizations where the proceeds from admissions inure exclusively to the benefit of such institutions, societies, or organizations or exclusively to the benefit of persons in the military or naval forces of the United States, are exempt from tax. To qualify for exemption the institution, society or organization must be the owner of the edifice; and (1) it must have a definite organization, with officers, directors, or trustees, and the usual essential features (incorporation not being essential) of an association of its class; (2) it must have a purpose which, as put into practice, is religious, educational, or charitable; and (3) its funds must be used exclusively in furtherance of such purpose, none of them being paid or otherwise being distributed to any of its members except as charity or as reasonable compensation for services actually rendered.

**7594 Art. 18. Theaters open for part of year only.**—Where theaters are entirely closed to performances during the months of July and August and open in the month of September the special tax is to be reckoned from the first day of September to the last day of June following at the specified annual rate—that is, for 10 months. Where a theater is closed before the end of a fiscal year, the stamp issued has no redeemable value.

**7595 Art. 19. Seating capacity.**—Where seats consist of boards or benches, seating capacity should be ascertained by allowing space for each spectator of the same width as the inside measurement of the average or standard theater chair. Where, after payment of special tax at a certain rate, the seating capacity of a theater is increased beyond that which the tax previously paid is sufficient to cover, an additional amount must be paid as special tax equal to the difference between the amount of tax due upon the enlarged theater and the value of the old special tax stamp, computed from the first day of the month in which the seating capacity of the theater was increased to June 30 following. For example:

Special tax due and paid July 1, 1922.....	\$50.00
Seating capacity increased Oct. 10, 1922 (new rate).....	100.00

Difference.....	\$50.00
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**SPECIAL TAXES ON OCCUPATIONS REGULATIONS.**

**7596** Since nine months are remaining in the fiscal year from the date of October 1, the additional tax due is nine-twelfths of \$50, or \$37.50, which amount must be paid to the collector and evidenced by receipt on Form 1. This receipt must be posted with the special tax stamp in the place of business of the holder until the close of the fiscal year, when a new special tax stamp for the succeeding fiscal year must be procured. A person failing to pay special tax covering increased seating capacity within the month during which liability begins, incurs liability to the penalty imposed by Section 1004 of the Revenue Act of 1921. Where a special tax stamp "at large" is issued to a proprietor of a traveling theater having a seating capacity of more than 250 and not exceeding 500 the stamp is good for any theater having a seating capacity of not exceeding 500. No new liability is created when the proprietor gives a performance in a theater with a seating capacity of less than 250. If, however, he gives a performance in a theater having a seating capacity of more than 500, liability at the increased rate of tax is incurred.

**7597 Art. 20. Transfer of stamp.**—A special tax stamp taken out by the proprietor of a theater who transfers his interest to another person can not be transferred and made to answer for such other person in conducting the theater. A special tax stamp is personal to the one to whom issued. Upon request to the collector he may have the stamp transferred from one place of business to another. Thus, if a proprietor of a theater closes it during the summer season he may have his stamp transferred to a summer theater, provided the seating capacity of such theater is not greater than that of his other theater; if the seating capacity of the summer theater is greater than that of his other theater, the proprietor will be required to pay an additional tax, measured by the difference in seating capacity. The proprietor of a summer theater who operates another theater during the winter season may likewise have his special tax stamp transferred from his summer theater to his other theater.

**7598 Art. 21. Population.**—In determining population of cities, towns, or villages latest United States census figures are to be used, unless a State census has been taken more recently, in which case the State census figures shall be used. However, in case of a sudden and considerable increase or decrease in population since the last United States or State census, the collector of the district in which the particular city, town, or village is located shall determine the population from the best evidence available, which may be common knowledge, and the tax shall be paid accordingly.

**CIRCUSES.**

**7599 Art. 22. Circuses: Persons liable.**—Exhibitions or feats of horsemanship which occur on race tracks are subject to a special tax of \$100; but mere tests of speed of horses in racing or jumping contests are not regarded as feats of horsemanship within the meaning of the statute. The "theatrical performances" contemplated by this subdivision are only those which are given in connection with a circus. A show under canvas exhibiting among other things acrobatic and athletic exercises, but no feats of horsemanship, and having no menagerie, is not subject to special tax as a circus if these exercises are few and simple, but is taxable under subdivision



## SPECIAL TAXES ON OCCUPATIONS REGULATIONS.

(7). A small wagon show having no "circus feats," but only trapeze performing, wire walking, trained ponies, singing, and dancing, is not to be regarded as a circus, but is taxable under subdivision (7). A "round-up" and like contests in which the contestants are from the locality, sponsored and financed by citizens of the community, are not circuses even though feats of horsemanship are shown and no tax liability as a circus is incurred. A Wild West show is taxable as a circus. Side shows at circuses are liable to tax under subdivision (7).

**7600 Art. 23. Payment in different States.**—Where a circus is exhibiting in any State in the month of July the special tax of \$100 is required to be paid for the year beginning July 1. If in the following month the circus goes into another State the special tax at the rate of \$100 for the year is to be reckoned from the first day of August to the last day of June following, and a separate special tax stamp must be taken out for that State, and for every other State, Territory, or District in which performances are given. If a circus, after leaving a State in which special tax has been paid, returns before the close of the fiscal year, no further special tax is due.

## OTHER PUBLIC EXHIBITIONS OR SHOWS.

**7601 Art. 24. Other public exhibitions or shows for money: Taxable ex-**  
**7508 hibitions.**—Proprietors or agents of all public exhibitions or shows for money not enumerated in the two previous subdivisions are liable to tax under this subdivision. The proprietors of the following exhibitions or shows are liable to tax under this subdivision:

**7602 (a)** An airdrome or summer theater which has no roof over the auditorium or stage;

**7603 (b)** A theatrical troupe traveling around the country and giving performances in halls or auditoriums for which special taxes have not been paid by the owners or lessees thereof;

**7604 (c)** An open-air picture exhibition for admission to which a charge is made;

**7605 (d)** An exhibition or show given on fair grounds but not under the management of the fair association;

**7606 (e)** A side show at a carnival or circus to which an admission fee is charged;

**7607 (f)** A dancing pavilion upon a pier where a charge is made for the privilege of going upon the pier as spectators;

**7608 (g)** A public dance hall, if a charge is made to persons who attend as spectators;

**7609 (h)** An illustrated lecture to which an admission fee is charged;

**7610 (i)** Baseball games by professionals or semiprofessionals to which an admission fee is charged;

**7611 (j)** Concert gardens where no admission fee is charged but where drinks are sold and stage and other entertainments are given.

**7612 Art. 25. Exhibitions not taxable.**—Subdivision (7) specifically provides "that this paragraph shall not apply to Chautauquas, lecture lyceums, agricultural or industrial fairs, or exhibitions held under the auspices of religious or charitable associations." Illustrated lectures or other exhibitions given by bona fide lecture lyceums or Chautauquas in a tent or other place during the usual Chautauqua or lecture lyceum season are exempt from tax. Exhibitions or shows given by an agricultural or industrial fair

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association in connection with the conduct of a fair are likewise exempt from tax. It is immaterial whether a separate charge is made for admission to such exhibitions or shows. Where, however, an exhibition or show, for admission to which a charge is made, is conducted on the fair grounds, but is not given by the fair association, the proprietor of such exhibition or show is liable to special tax. Special tax is not required to be paid by proprietors of restaurants or cafes employing orchestras during the meal hours for the entertainment of patrons. Amateur theatrical exhibitions either in private houses or in licensed public halls to which an admission fee is charged to cover expenses incurred in giving the exhibition, and not for the pecuniary profit of the performers or the manager, are not such performances as are subject to special tax. Owners or agents of theatrical troupes giving performances only in halls or auditoriums for which special taxes have been paid by the owner or lessee thereof are not subject to tax. Persons conducting stands and raffling devices at beaches, summer resorts, and similar places, at which no charge is made for admission but only a charge for taking a chance, are not subject to the tax. This is also true of merry-go-rounds, shoot-the-chutes, and similar amusement devices.

**7613 Art. 26. Aggregation of entertainments.**—An aggregation of entertainments known as a street fair is not subject to a larger tax than \$100 in any State, Territory, or the District of Columbia. When seven or more separate entertainments are under the same management and are conducted in connection with a street fair, the total amount of tax payable shall not exceed \$100. These aggregations usually include such exhibitions or shows as "pit shows," "rides," "dare-devil entertainments," imitation Wild West shows, or trained animals. A special tax stamp has been provided for such aggregations.

## BOWLING ALLEYS.

**7614 Art. 27. Bowling alleys: Scope of tax.**—In every building or place where bowls are thrown each division or track is a separate alley, for which a special tax must be paid. Proprietors of bowling alleys and billiard and pool tables in clubs, Y. M. C. A. buildings, hotels, fraternity houses, lodge rooms, State armories, fire houses, and similar places are subject to special tax unless the bowling alley or billiard and pool tables are supported out of funds contributed by a State or a subdivision of a State. The Italian game of "Boccie" is taxable under this subdivision. Bagatelle and tivolli tables and Japanese rolling ball games are not subject to tax. No liability is incurred where tables or alleys are not actually used, in which case pins and bowls should be removed from the alleys and cushions from tables. The person for the time being in possession or control of a billiard table or bowling alley is prima facie the proprietor of the alley or table and liable to the special tax even if the property and ultimate control of the table and place where it is located are in some one else. A "private home" is held to be an individual or family residence. The mere fact that no charge is made for use of the tables or alleys, or that they are not operated for profit, does not relieve the proprietor from payment of the special tax.

**7615 Art. 28. Transfer of special tax stamp.**—When a person who has taken out a special tax stamp for a bowling alley closes the alley and thereafter opens another the stamp may be transferred to the latter.



## SPECIAL TAXES ON OCCUPATIONS REGULATIONS.

## SHOOTING GALLERIES.

**7616 Art. 29. Shooting galleries: Persons liable.**—Every person who is  
 7510 in possession and control of any building, space, tent, or area where a charge is made for the discharge of firearms at any form of target is liable to tax. A club which charges annual dues and in addition makes a charge to cover operating expenses of a shooting range is liable to tax. The tax attaches in the case of a gun club where the membership dues specifically cover participation in shoots or tournaments.

## RIDING ACADEMIES.

**7617 Art. 30. Riding academies: Liability to tax.**—Only a proprietor of  
 7511 a riding academy who maintains a building, space, tent, or area where a charge is made for instruction in horsemanship or for facilities for the practice of horsemanship is liable to tax. Persons who are engaged merely in letting saddle horses are not liable to tax. A highway or other place, the use of which is open to the public generally, that is not restricted by concession or otherwise to a person giving instruction in horsemanship, is not a "building, space, tent, or area" within the meaning of this section and subdivision of law. Associations composed exclusively of members of units of the Federalized National Guard or the Organized Reserve and whose receipts are used exclusively for the benefit of such units, are exempt from tax.

## PASSENGER AUTOMOBILES.

**7618 Art. 31. Passenger automobiles: Basis of tax.**—The tax is upon  
 7512 the business of operating or renting passenger automobiles for hire, and is based upon the number of cars operated or rented and the seating capacity of each car. It is upon the total number of cars operated and not upon the average number operated. Liability is not incurred through the occasional carrying of a passenger in an automobile for hire provided the owner or operator does not hold himself out to the public as engaged in the business of carrying passengers. A person, however, who habitually carries passengers for hire whenever the opportunity presents or the capacity of his car permits is liable to tax. In computing seating capacity the driver's seat is to be included. The tax should be paid for automobiles used for carrying passengers, based upon the seating capacity of the whole car, unless a portion of it is set off and is of such design that it can not readily be used for passengers. ¶The tax attaches to a person operating a hotel bus for the carriage of passengers between railroad stations and hotels, provided a separate charge is made for the service. Motor trucks used for carrying passengers for hire are liable to tax, and unless evidence is furnished which conclusively shows that such trucks can not accommodate more than seven persons the owners are liable to the special tax of \$20 for each. Persons operating or renting passenger automobiles for hire during a strike of street-railway employees are liable to the tax. A company operating automobile stages or motor busses on fixed schedule over established routes in cities or between cities and carrying passengers at a fixed charge is subject to tax even though it operates under rules and regulations of a state railroad commission or similar body. ¶Automobile ambulances and automobile hearses are not considered passenger automobiles within the purview of this subdivision.

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**7619 Art. 32. Special tax stamp.**—The special-tax stamp or stamps issued must cover the total tax liability of the taxpayer at the time the stamp or stamps are taken out. He must secure a stamp for each car operated. A taxpayer does not incur an increased liability to tax by reason of replacing a car with a new car unless the new car is of a seating capacity subject to a higher rate of tax than the car replaced. For example: A person engaged in the business of operating passenger automobiles for hire owns 40 machines, each of them carrying more than two but not more than seven passengers. He takes out a special-tax stamp on each of the 40 machines covering his total liability. In February he sells 7 of his machines and purchases new ones of the same seating capacity or of a seating capacity of not more than seven. In such case no additional special-tax liability is incurred. If, however, in February he should replace 7 of his old machines with the same number of new machines each carrying more than seven passengers, an additional amount must be paid as special tax equal to the difference between the amount of tax due upon the operation of the new machines and the value of the old special-tax stamps paid upon the operation of the replaced machines, computed from the first day of the month in which additional liability was incurred and ending with the following June 30. Thus, since five months are remaining in the fiscal year from the date of February 1, the additional tax due is five-twelfth of \$70, or \$29.17. Payment of such additional special tax will be evidenced by a receipt on Form 1, which must be kept posted with the special tax stamp until the close of the fiscal year. A person failing to pay special tax covering increased seating capacity within the month during which liability begins incurs liability to the penalty imposed by section 1004 of the Revenue Act of 1921. ¶The purchaser of a passenger automobile for the operation of which special tax has been paid by the previous owner does not acquire the right to operate the automobile under the special-tax stamp which was issued to the previous owner. The special-tax stamp or stamps issued must be conspicuously posted in the place of business of the person operating or renting passenger automobiles. ¶Automobiles in respect of which special tax has been paid may be operated at any place in the United States without the payment of additional tax so long as the owner remains the same. When a special-tax stamp is issued, the engine number of the car covered by the stamp shall be registered with the collector issuing the stamp, who, in addition to the stamp, will issue a receipt card for each car which will bear the number corresponding to that on the engine of the car for which issued, and this receipt shall be carried by the operator at all times. The operation of a car without a receipt card or with a receipt card bearing a different engine number than that on the engine of the car operated shall be prima facie evidence of evasion of tax. Any replacement of a car must be likewise registered with the collector and a new receipt card will be issued in lieu of the card originally issued for the car which the new car replaces. ¶It is not considered necessary nor is it desirable to put the license-tag number on the receipt card issued with the stamp, owing to the fact that the stamp shows payment of tax for a fiscal year, while auto license tags usually cover a calendar year. The engine number on the card will be sufficient. This will obviate the necessity of obtaining a new card when the tag is changed. However, it will be necessary to obtain a new card in all cases where, for any reason, a different car is replacing an old one.



## SPECIAL TAXES ON OCCUPATIONS REGULATIONS.

## SPECIAL TAXES UPON THE USE OF BOATS.

**7620 Art. 33. Effective date.**—The effective date of the tax on boats is July 1, 1922. This tax is in lieu of a similar tax imposed by section 1003 of the Revenue Act of 1918.

**7621 Art. 34. Taxable period.**—The first taxable period is from July 1, 1922, or from the date of the original purchase of a new boat by a user, to June 30, 1923, inclusive. Succeeding taxable periods cover the fiscal year beginning July 1 and ending June 30 of the succeeding year.

**7622 Art. 35. Basis of tax.**—The tax is based on use and not on mere possession or ownership. Liability to tax begins from the first day of the month in which the boat is used. Thus, if the first use of a boat is on April 27, 1923, the liability to tax begins on April 1, 1923. A boat which is not used at all during a fiscal year is not subject to tax for that period notwithstanding the fact that it might have been liable to tax in the preceding fiscal year. A boat which is not placed in use during the first part of the fiscal year is not liable to the tax for the period during which it was not in use, except to the extent of becoming liable from the first of the month during which it was placed in use. Once liability has been incurred at some time during a fiscal year the tax must be paid from the first of the month during which the boat was first placed in use until the close of the fiscal year, and no refund will be made notwithstanding the fact that during some subsequent period of such fiscal year the boat may not be in use.

**7623 Art. 36. Person s liable.**—The owner, lessee, or charterer of a boat is liable for the tax.

**7624 Art. 37. Boats taxable.**—Subject to the exemptions provided for in Article 38, the tax is imposed upon the use of yachts, pleasure boats, power boats, motor boats with fixed engines, and sailing boats of over 5 net tons, length over 32 feet. The use of the following boats, among others, is subject to tax:

- (a) Boats of foreign register used in the United States;
- (b) Boats owned by nonresident aliens navigating United States waters;
- (c) Boats built according to plans and specifications approved by the Navy Department but subsequently converted or remodeled according to plans not approved by the Navy Department;
- (d) Boats built without prior approval of the plans and specifications by the Navy Department.

**7625 Art. 38. Boats not subject to tax.**—(a) Boats used exclusively for trade are specifically exempt from tax. (Any boat which is used exclusively in connection with any serious activity which constitutes a person's business, occupation, profession, or means of livelihood is exempt from tax. Casual employment at irregular intervals for the convenience of the owner or his family, not exceeding such casual employment as is usual for boats maintained or employed in trade, will not cause the tax to attach to a boat which is entirely devoted to trade except for such limited casual use.)

(b) Boats used exclusively for fishing are specifically exempt from tax. (The term "fishing" as used in the statute has reference to commercial fishing and not fishing for pleasure.)

**SPECIAL TAXES ON OCCUPATIONS REGULATIONS.**

(c) Boats built according to plans and specifications approved by the Navy Department are specifically exempt from tax. (In order to be exempt the plans and specifications must receive approval by the Navy Department prior to the building of the boat.)

(d) Vessels or boats used without profit by any benevolent, charitable or religious organizations exclusively for furnishing aid, comfort, or relief to seamen are specifically exempt from tax.

(e) Boats owned by nonresident aliens and operated only occasionally in American waters are not subject to tax.

(f) A houseboat without means of propulsion is not subject to tax.

(g) Boats of over 5 net tons but less than 32 feet in length, and boats of over 32 feet in length but less than 5 net tons, do not fall within the purview of the act and are not subject to tax.

(h) A boat used by a physician in calling upon patients is exempt from tax.

(i) A boat used by a farmer to take produce to market, farming constituting the means of livelihood of the owner of the boat, is exempt from tax.

(j) A boat used by an owner in the course of his employment to tend channel lights on a barge canal is exempt from tax.

(k) A boat regularly in service in the carriage of the public is exempt from tax.

(l) A boat used by a marine-engine manufacturer in transporting salesmen on their business trips or in taking out prospective customers purely for demonstrating purposes is exempt from tax.

(m) A boat used in towing disabled boats and furnishing repair service to customers is exempt from tax.

**7626 Art. 39. Purchase or use of secondhand boats.**—If a person purchases a secondhand boat on which special tax has already been paid, he is not liable to special tax upon the use of the boat during the balance of the fiscal year. The tax is on the use of the boat and the special tax stamp passes with it. The adjustment of the tax between the vendor and the vendee is a matter of individual contract in which the Government has no concern. If a person leases or charters a boat upon which the tax has been paid, the lessee or charterer is exempt from tax on the use of the boat during the remainder of the fiscal year.

**7627 Art. 40. Rate and computation of tax.**—The boats enumerated in the act are divided into three classes with respect to length, and a separate rate of tax is provided for each class, as follows:

(a) Over 5 net tons, length over 32 feet and not over 50 feet, \$1 for each foot.

(b) Over 5 net tons, length over 50 feet but not over 100 feet, \$2 for each foot.

(c) Over 5 net tons, length over 100 feet, \$4 for each foot.

**7628** To compute the amount of tax in any given instance multiply the rate of the class in which the boat is included by the number representing the length over all in full feet. For example: A boat 49.5 feet in length would be included in class (a) and would be taxed at the rate of \$1 for each foot, or \$49; a boat 50.5 feet in length would also be included in class (a) and would be taxed at the rate of \$1 for each foot, or \$50. A boat must be at least 33 feet in length in order to be taxable.



## SPECIAL TAXES ON OCCUPATIONS REGULATIONS.

**7629 Art. 41. Tonnage.**—To estimate the net tonnage of a vessel, the following rules may be used:

(a) By the word "ton" is meant 100 cubic feet of space.

(b) Multiply the extreme length of the vessel by the extreme breadth and that product by the depth from the underside of the deck to the frame in the hold taken amidships. The result should be multiplied by six-tenths. To this result should be added the cubical contents of any closed-in structure above the upper deck. The sum should be divided by 100, which will give the approximate gross tonnage of the boat.

A closed-in superstructure is any space inclosed with wood or glass, whether stationary or removable, but does not include awnings or canvas shelters.

(c) From this gross tonnage may be deducted all spaces used exclusively in connection with the navigation of the boat or for machinery space, space for officers and crew but not for passengers (who include all persons not actual members of the crew), storage of sails, navigation instruments, boatswain's stores, etc. The result will be the approximate net tonnage of the boat.

(d) For the purpose of determining the tonnage of open boats the space within the boat level with the outer rails will be considered, and no deductions for machinery or crew will be made.

**7630** If the boat is over 32 feet in length and the net tonnage thus estimated is more than 4 net tons, application should be made to the nearest customs officer for official admeasurement. If an official admeasurement is not completed before the date on which a return is required, a return should be rendered; and if the estimate of net tonnage, made as above directed, is over 5 net tons, the tax should be paid. If an official admeasurement is being made or has been requested but not completed on the date set for filing return, the taxpayer should file his return on the date set by the law and regulations, accompanied by a remittance in an amount which he has determined is due. The collector will, upon receipt of such return and remittance, deposit the remittance as an advance collection in his stamp account, but will not order an improvised stamp for the taxpayer until the official admeasurement has been completed. If the tax due as shown by such official admeasurement is greater than that already paid by the taxpayer such taxpayer should be called upon for an additional amount sufficient to cover his total liability. When this additional amount is received the collector will then order an improvised stamp of the proper denomination. If the amount of tax is found to be the same as or less than the amount remitted by the taxpayer the collector will order an improvised stamp of the proper denomination, take credit in his stamp account for any excess remittance, and transfer the balance to account 9e. The collector will then place the item covering the excess payment on his Schedule of Refunds, Form 7777a. By this method the taxpayer will not be burdened with the necessity of purchasing a new special tax stamp in the proper amount and returning the original stamp for redemption, but will receive a stamp in the proper denomination in the first instance.

**7631 Art. 42. Over-all length.**—Over-all length is defined as the extreme length of the structure—i. e., from the forward side of the stem outside the planking or plating to the aftermost side of the stern planking or plating, whether above or below the water line. The measurement should be to the outside of any planking or plating extending above the deck, constituting bulwarks, and to the outside of any forecastle deck, quarter deck, or poop deck extending beyond the main deck. The length should be taken in a straight line, excluding any sheer there may be to the deck.

## SPECIAL TAXES ON OCCUPATIONS REGULATIONS.

**7632 Art. 43. Return and payment of tax.**—Every person liable to special tax must, during the month in which his liability begins, file with the collector or a deputy collector of the district in which he is located sworn return on Form 732 (Revised) which shall show the amount of tax due. This return shall also be filed by persons claiming exemption from tax on boats falling within the purview of the Act. Instructions for filling out Form 732 (Revised) will be found on the back of the form. The return due for the fiscal year ending June 30, 1923, must be filed during the month of July, 1922, provided the boat is used during the month of July, 1922. If the boat is placed in use during a month subsequent to July, return must be filed during such month.

**7633** If exemption is claimed the return must be executed in full and "exemption claimed" noted across the face of the return. Failure to file Form 732 in the case of a tax-exempt boat renders a person liable to a penalty of not more than \$1,000 (sec. 1302 (a) of the act). Return is not required with respect to boats of not over 5 net tons and not over 32 feet in length.

**7634 Art. 44. Stamp or card certificates.**—When tax is paid a special tax stamp indicating payment and a card certificate showing the name and other description of the boat will be issued. If exemption is allowed, an exemption card (Form 725) will be issued. The card certificate or exemption card issued must be kept on board whenever the boat is in use, and must be shown on demand to any officer or agent of the internal revenue or navigation service. No exemption certificate is required for a boat falling below the tonnage and footage specifications mentioned in the Act.

### PROVISIONS OF LAW AND REGULATIONS PERTAINING TO SPECIAL TAXES.

**7635 Art. 45. Special taxes.**—The taxes imposed by sections 1001 and 7501 1003 of the Revenue Act of 1921 are "special taxes," and taxpayers are subject, under these sections, to all applicable provisions of the internal-revenue laws now in force and effect.

**7636 Art. 46. Business to be registered.**—Every person engaged in any trade or business on which a special tax is imposed by law shall register with the collector of the district his name or style, place of residence, trade or business, and the place where such trade or business is to be carried on. In case of a firm or company, the names of the several persons constituting the same, and their places of residence, shall be so registered. (Sec. 3233, R. S.)

**7637 Art. 47. Partnerships.**—Any number of persons doing business in copartnership at any one place shall be required to pay but one special tax. (Sec. 3234, R. S.)

**7638 Art. 48. Payment of one special tax not to cover several places of business.**—The payment of the special tax imposed does not exempt a person carrying on a trade or business in any other place than that stated in the collector's register from the payment of an additional special tax on the doing of such business; but a special tax is not required for the storage of goods, wares, or merchandise in other places than the place of business, nor for the sale by manufacturers or producers of their own goods, wares, and merchandise at the place of production or manufacture, and at their



**SPECIAL TAXES ON OCCUPATIONS REGULATIONS.**

principal office or place of business, provided no goods, wares, or merchandise shall be kept except as samples at said office or place of business. (See sec. 3235, R. S.)

**7639 Art. 49. More than one pursuit carried on in the same place of business.**—Whenever more than one of the pursuits or occupations subject to special taxes are carried on in the same place by the same person at the same time, the tax shall be paid for each according to the rates severally prescribed. (See sec. 3236, R. S.)

**7640 Art. 50. When special tax becomes due.**—All special taxes shall become due on the 1st day of July in each year, or on commencing any trade or business on which such tax is imposed. In the former case the tax shall be reckoned for one year; and in the latter case it shall be reckoned proportionately from the 1st day of the month in which the liability to a special tax commenced to the 1st day of July following. (See sec. 3237, R. S., as amended by sec. 53, act of Oct. 1, 1890; 26 Stat., 567.) An applicant for a special-tax stamp for a fractional part of a year must calculate from the 1st day of the month in which he commences business and must pay until the end of the fiscal year. A special tax payer, even though he makes a sworn return within the calendar month of his liability, is liable to criminal prosecution if he fails to pay the tax within that month or to post the stamp in his place of business, although he is not liable to the additional tax imposed by section 3176, Revised Statutes, as amended.

**7641 Art. 51. Returns.**—It shall be the duty of special tax payers to render their returns to the collector or a deputy collector at such times within the calendar month in which the special tax liability commenced as shall enable him to receive such returns, duly signed and verified, not later than the last day of the month, except in cases of sickness or absence, as provided for in section 3176 of the Revised Statutes as amended. (See sec. 3237, R. S., as amended by sec. 53, act of Oct. 1, 1890; 26 Stat., 567.) For failure to make a sworn return within the time prescribed by law, without a reasonable cause for delinquency, the Commissioner of Internal Revenue is required to add to the special tax 25 per cent. of its amount. In case a false or fraudulent return or list is willfully made, the Commissioner of Internal Revenue is required to add to the special tax 50 per cent. of its amount. (See art. 64.)

**7642 Return and tax due during July, generally.**—[Comment: The following letter may be of interest, to be read in connection with the "calendar" on page 1501.] Reference is made to your letter of the 6th inst. in which you refer to Form 11 and inquire by what authority this form calls for the filing of the return before July 1st of each year. You state you have been unable to find anything in the Revised Statutes or in the Revenue Act of 1918 that warrants the statement printed in bold face type at the bottom of the return form.

**7643** In reply you are advised that there is no requirement of law that the return must be filed on or before July 1st. The statement printed on the form, and referred to by you, is to be eliminated. Section 53 of the Act of October 1, 1890 (26 Stat., 567) amends Section 3237, Revised Statutes, and distinctly provides that special taxpayers shall render their returns at such times within the calendar month in which the special tax liability commenced as shall enable the collector to receive such returns

## SPECIAL TAXES ON OCCUPATIONS REGULATIONS.

duly signed and verified not later than the last day of the month. (Letter to The Corporation Trust Company, signed by Deputy Commissioner James M. Baker, and dated December 27, 1919.)

**7644 Art. 52. Stamps for special taxes.**—All special taxes imposed by law shall be paid by stamps denoting the tax, and the Commissioner of Internal Revenue is required to procure appropriate stamps for the payment of such taxes; and the provisions of sections 3312 and 3446, Revised Statutes, and all other provisions of law relating to the preparation and issue of stamps for distilled spirits, fermented liquors, tobacco, and cigars shall, so far as applicable, extend to and include stamps for special taxes; and the Commissioner of Internal Revenue shall have authority to make all needful regulations relative thereto. (See sec. 3238, R. S.)

**7645** A special tax stamp issued is not a license, but merely a receipt for the tax. It puts the United States under no obligation whatever to the holder beyond assuring him against prosecution under the special tax laws. The firm name is the only name that is necessary in a special tax stamp issued to a partnership. Collectors or their deputies are forbidden to issue receipts for moneys received for taxes which are payable by stamps.

**7646 Art. 53. Special tax stamps "at large."**—Any special tax payer except those liable to tax under subdivisions (6) and (7) of section 1001, whose business is such as to require him to travel from place to place in different States of the United States, such as proprietors of traveling theaters, proprietors of shooting galleries traveling with circuses, etc., may procure a special tax stamp "at large" covering, with the payment of but one special tax, the activities of such special tax payer throughout the United States. Collectors of internal revenue are instructed to issue such special tax stamps "at large" upon receipt of application and remittance covering the amount of tax due.

**7647 Art. 54. Special tax stamp to be posted in place of business.**—

Every person engaged in any business, vocation, or employment who is thereby made liable to a special tax shall place and keep conspicuously in his establishment or place of business all stamps denoting the payment of said special tax; and any person who shall, through negligence, fail to so place and keep said stamps, shall be liable to a penalty equal to the special tax for which his business renders him liable, and the costs of prosecution; but in no case shall said penalty be less than \$10. And where the failure to comply with the foregoing provision of law shall be through willful neglect or refusal, then the penalty shall be double the amount above prescribed: *Provided*, That nothing in this section shall in any way affect the liability of any person for exercising or carrying on any trade, business, or profession, or doing any act for the exercising, carrying on, or doing of which a special tax is imposed by law, without the payment thereof. (See sec. 3239, R. S.)

**7648 Art. 55. List of special taxpayers.**—Each collector of internal revenue shall, under regulations of the Commissioner of Internal Revenue, place and keep conspicuously in his office, for public inspection, an alphabetical list of the names of all persons who shall have paid special taxes within his district, and shall state thereon the time, place, and business for which each such special tax has been paid; and upon application of any prosecuting officer of any State, county, or municipality he shall furnish a

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## SPECIAL TAXES ON OCCUPATIONS REGULATIONS.

certified copy thereof, as of a public record, for which a fee of one dollar for each one hundred words or fraction thereof in the copy or copies so requested may be charged. (Sec. 3240, R. S., as amended by the act of June 21, 1906; 34 Stat., 387.)

**7649** Records in the collectors' offices relating to special tax payers are based on returns made by these persons under compulsion of law for the sole purpose of raising revenue for the United States. Collectors are not permitted to send out these records or copies thereof for use against the special tax payers in cases not arising under the laws of the United States. This restriction does not apply to copies of record 10, which the collector is required by the act of June 21, 1906, to furnish to prosecuting officers upon payment of the prescribed fee.

**7650** **Art. 56. Death or removal after paying tax.**—When any person who has paid the special tax for any trade or business dies, his wife or child, or executors or administrators or other legal representatives, may occupy the house or premises, and in like manner carry on, for the residue of the term for which the tax is paid, the same trade or business as the deceased before carried on, in the same house, and upon the same premises, without the payment of any additional tax. And when any person removes from the house or premises for which any trade or business was taxed to any other place, he may carry on the trade or business specified in the collector's register at the place to which he removes, without the payment of any additional tax: *Provided*, That all cases of death, change, or removal, as aforesaid, with the name of the successor to any person deceased, or of the person making such change or removal, shall be registered with the collector, under regulations to be prescribed by the Commissioner of Internal Revenue. (Sec. 3241, R. S.)

**7651** Under the law and rulings of this office an executor, receiver, or referee in bankruptcy may continue the business under the stamp issued to the deceased or bankrupt taxpayer at the place and for the period for which the tax was paid. An assignee may continue business under his assignor's special tax stamp without incurring special tax liability.

**7652** **Art. 57. Transfer of place of business.**—Whenever the special tax payer desires to remove his business to a place other than that specified in his original return and stated in his special tax stamp he shall, during the calendar month in which such transfer is made, register such fact by filing under oath an additional return on the prescribed form, properly modified, setting forth the time and place where he intends to engage in the business described; and if such taxpayer is a firm or corporation, the names and residences of all the members or principal officers thereof shall again be recorded. He shall also forward the special tax stamp to the collector in order that proper notation of the transfer may be made thereon, after which it will be returned to the owner. Should the transfer be made to a location in another collection district, the stamp will be forwarded to the collector who issued it, who will make proper notation on his record 10 and make notation on the stamp as to transfer. This collector will then forward the stamp to the collector of the district to which the taxpayer will transfer, who will make out a proper record 10 card and sign the stamp under the signature of the transferring collector, and forward the stamp to the taxpayer. Unless such transfer notice is filed within the time specified a new special tax liabil-

## SPECIAL TAXES ON OCCUPATIONS REGULATIONS.

ity will be incurred and a new special tax stamp will be required for the carrying on of the business.

**7653 Art. 58. Change in membership of firm.**—When one or more members of a firm or partnership withdraw the business may be continued by the remaining partner or partners under the same special tax stamp, but where new partners are taken into a firm the new firm can not carry on business under the special tax stamp of the old firm. It must make return and pay its own special tax reckoned from the first day of the month in which it began business, even though the name of the new firm be the same as that of the old.

**7654 Art. 59. Change from partnership to corporation.**—Where a partnership paying special tax incorporates a special tax stamp must be taken out in the name of the corporation.

**7655 Art. 60. Who may carry on business without new stamp.**—A corporation may, upon application to the collector, change its name without creating new special tax liability, provided its charter permits such a change. A copy of the charter must be filed with the application and the stamp forwarded to the collector for proper notation. Additional special tax stamp is not required by reason of an increase of capital stock of a corporation if State laws creating the corporation provide for such changes without the formation of a new corporation. Additional tax stamp is not required of an unincorporated club by reason of changes of membership where such changes do not result in a dissolution and formation of a new club.

**7656 Art. 61. Changes to be registered.**—Whenever such a person as is permitted under article 60 to carry on the business of one who has paid the required special tax succeeds to such business he shall register with the collector under oath the name of the original taxpayer and the names of such successors and their residences together with all the data required. Any person succeeding to and carrying on the business for which special tax is required to be paid on removing to and carrying on such business at a place other than that for which the special tax was paid without registering such change on removal will be regarded as carrying on the business in violation of law, and will be liable to a fine of not less than \$10 nor more than \$500, in addition to his liability for the tax. (See sec. 3242, R. S.)

## General Administrative Provisions.

**7657 Art. 62. Aid to collection of tax.**—In collecting the special taxes the Commissioner has the benefit of all existing internal-revenue laws.

In aid of the enforcement of the statute the Commissioner may require any person to keep specified records, to render returns and statements as directed, to submit himself and his books to examination, and to comply with such regulations as may be prescribed.

## PENALTIES.

Sec. 1311. (Sec. 3176 Rev. Stats.) ¶8071.

Sec. 1004. ¶7534.

Sec. 1302. ¶8014.

Sec. 3184, R. S. Where it is not otherwise provided, the collector shall in person or by deputy, within ten days after receiving any list of taxes from the Commissioner of In-

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## SPECIAL TAXES ON OCCUPATIONS REGULATIONS.

ternal Revenue, give notice to each person liable to pay any taxes stated therein, to be left at his dwelling or usual place of business, or to be sent by mail, stating the amount of such taxes and demanding payment thereof. If such person does not pay the taxes within ten days after the service or the sending by mail of such notice, it shall be the duty of the collector or his deputy to collect the said taxes with a penalty of five per centum additional upon the amount of taxes, and interest at the rate of one per centum a month.

**7658** **Art. 63. Penalties.**—Any person who fails to file a return of tax due  
**8071** within the time prescribed by law or regulations made pursuant to law is liable to an additional amount equal to 25 per cent. of the total tax due except when it is shown that the failure to file the return within the prescribed time was due to a reasonable cause and not to willful neglect. If a false or fraudulent return is filed the taxpayer is liable to an additional amount equal to 50 per cent. of the total tax. A person who fails to pay or truly to account for any tax or to make any return prescribed by law is in addition to the increased tax as set forth above liable to a penalty of not more than \$1,000. If he willfully refuses to pay or account for any tax or make any return required by law, or willfully attempts in any manner to evade the tax he is guilty of a misdemeanor and in addition to the increased taxes provided for he is liable to a fine of \$10,000, or imprisonment for not more than one year, or both, together with the costs of prosecution. Where a false or fraudulent return is filed it is considered prima facie evidence of a willful attempt to evade tax and the penalties provided by law for such offense will be invoked. Under section 3184, Revised Statutes, a taxpayer who does not pay a special tax assessed within 10 days from the date of the mailing by the collector of a notice and demand for payment is liable to a 5 per cent. penalty and interest at the rate of 1 per centum per month.

**7659** **Art. 64. Claims for refund of special taxes.**—(a) In all cases where special tax has been collected and such collection is alleged to be illegal or erroneous, it will be necessary for the person so paying the tax to file claim for refund on Treasury Department Form 843, obtainable at the office of the collector. The completed claim should be filed with the collector and should be accompanied by the special-tax stamp, or receipt, representing payment of the amount claimed.

**7660** (b) No claim for the redemption of or allowance for special-tax stamps shall be allowed unless presented within two years after the purchase of said stamps from the Government. The authority for such redemption or allowance is the act of May 12, 1900 (31 Stat. 177), as amended by the act of June 30, 1902 (32 Stat. 506) [see ¶8024 herein].

**7661** (c) Where taxes are paid pursuant to an assessment and not by the issuance of stamps, claims for the refund of amounts so paid are governed by sections 3220 to 3228 R. S., as amended, and must be presented within four years next after payment of such taxes, as provided in section 1316 of the Revenue Act of 1921.

## AUTHORITY FOR REGULATIONS.

[Sec. 1309, ¶8009.]

**7662** **Art. 65. Promulgation of regulations.**—In pursuance of the statute  
**8009** the foregoing regulations are hereby made and promulgated, and all rulings inconsistent herewith are hereby revoked.

D. H. BLAIR,

*Commissioner of Internal Revenue.*

Approved: July 20, 1922. [Released for publication Aug. 2, 1922.]

A. W. MELLON,

*Secretary of the Treasury.*

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(T. D. 3451.)

*[By virtue of the amendments hereby effected, return and card and exemption certificates are not required in the case of any tax exempt boats.]*

**7663 Special tax on the use of boats.**—Article 43 and article 44 of Regulations No. 59 (1922 Edition) are hereby amended to read as follows:

**7664 Art. 43. Return and payment of tax.**—Every person liable to special  
7632 tax must, during the month in which his liability beings file with the  
7633 collector or a deputy collector of the district in which he is located  
sworn return on Form 732 (Revised) which shall show the amount  
of tax due. Instructions for filling out Form 732 (Revised) will be found on  
the back of the form. The return due for the fiscal year ending June 30, 1923  
must be filed during the month of July, 1922 provided the boat is used during  
the month of July, 1922. If the boat is placed in use during a month su-  
sequent to July return must be filed during such month. Failure to file  
Form 732 in the case of a boat subject to tax renders a person liable to a  
penalty of not more than \$1,000 (sec. 1302 (a) of the act). Return is not  
required with respect to boats of not over 5 net tons and not over 32 feet in  
length, nor with respect to boats specifically exempt under the law.

**7665 Art. 44. Stamp and card certificates.**—When tax is paid a special  
7634 tax stamp indicating payment and a card certificate showing the name  
or other description of the boat will be issued. The card certificate  
must be kept on board whenever the boat is in use, and must be shown on  
demand to any officer or agent of the internal-revenue or navigation service.  
No card certificate is required for a boat falling below the tonnage and  
footage specifications mentioned in the Act or a boat specifically exempt.  
(T. D. 3451, signed by Acting Commissioner C. R. Nash, and dated March  
13, 1923.)



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Rulings, Regulations, Opinions and Decisions  
under the

Occupations Tax Law Provisions.

Giving Treasury Decision Number or other Designation, General Subject Content,  
Date of Issue, and Paragraph References.

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<b>Reg. 59</b>	July 20, 1922	Comprehensive regulations relating to the special taxes on businesses and occupations and on the use of boats. (See exhaustive Table of Contents beginning on page 1513.)	
<b>Decision</b>	Oct. 21, “	Cothran & Connally vs. U. S. 4th Circuit Court of Appeals.—Tobacco warehousemen as brokers. (See note at ¶7556.)	
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3451	Mar. 13, 1923	Arts. 43 and 44, Reg. 59, amended.—Special tax on the use of boats.....	7663

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General Administrative  
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# MISCELLANEOUS MATTERS

## HAVING A

### GENERAL APPLICATION

BEING IN THE MAIN MISCELLANEOUS SECTIONS OF TITLE XIII AND TITLE XIV OF THE REVENUE ACT OF 1921.

**General Administrative, Special, and Stamp Tax Provisions of Law Extended to Apply to Revenue Act of 1921.**

**8000** (Law.) Sec. 1300 [of the Revenue Act of 1921]. That all administrative, special, or stamp provisions of law, including the law relating to the assessment of taxes, so far as applicable, are hereby extended to and made a part of this Act, and every person liable to any tax imposed by this Act, or for the collection thereof, shall keep such records and render, under oath, such statements and returns, and shall comply with such regulations as the Commissioner, with the approval of the Secretary, may from time to time prescribe.

### Statements May be Required of any Person.

**8001** (Law.) Sec. 1307 [of the Revenue Act of 1921]. That whenever in the judgment of the Commissioner necessary he may require any person, by notice served upon him, to make a return or such statements as he deems sufficient to show whether or not such person is liable to tax.

### Examination of Books and Witnesses.

**8002** (Law.) Sec. 1308 [of the Revenue Act of 1921]. That the Commissioner, for the purpose of ascertaining the correctness of any return or for the purpose of making a return where none has been made, is hereby authorized, by any revenue agent or inspector designated by him for that purpose, to examine any books, papers, records, or memoranda bearing upon the matters required to be included in the return, and may require the attendance of the person rendering the return or of any officer or employee of such person, or the attendance of any other person having knowledge in the premises, and may take his testimony with reference to the matter required by law to be included in such return, with power to administer oaths to such person or persons.

### Jurisdiction of Courts.

**8003** (Law.) Sec. 1310 [of the Revenue Act of 1921]. (a) That if any person is summoned under this Act to appear, to testify, or to produce books, papers or other data, the district court of the United States for the district in which such person resides shall have jurisdiction by appropriate process to compel such attendance, testimony, or production of books, papers, or other data.

**8004** (b) The district courts of the United States at the instance of the United States are hereby invested with such jurisdiction to make and issue, both in actions at law and suits in equity, writs and orders of injunction, and of ne exeat republica, orders appointing receivers, and such other orders

## MISCELLANEOUS LAW PROVISIONS AND REGULATIONS.

and process, and to render such judgments and decrees, granting in proper cases both legal and equitable relief together, as may be necessary or appropriate for the enforcement of the provisions of this Act. The remedies hereby provided are in addition to and not exclusive of any and all other remedies of the United States in such courts or otherwise to enforce such provisions.

**8005** (c) Paragraph Twentieth of section 24 of the Judicial Code is amended by adding at the end thereof the following new paragraph:

"Concurrent with the Court of Claims, of any suit or proceeding, commenced after the passage of the Revenue Act of 1921, for the recovery of any internal-revenue tax alleged to have been erroneously or illegally assessed or collected, or of any penalty claimed to have been collected without authority or any sum alleged to have been excessive or in any manner wrongfully collected, under the internal-revenue laws, even if the claim exceeds \$10,000, if the collector of internal-revenue by whom such tax, penalty, or sum was collected is dead at the time such suit or proceeding is commenced."

### Unnecessary Examinations.

**8006** (Law.) Sec. 1309 [of the Revenue Act of 1921]. That no taxpayer shall be subjected to unnecessary examinations or investigations, and only one inspection of a taxpayer's books of account shall be made for each taxable year unless the taxpayer requests otherwise or unless the Commissioner, after investigation, notifies the taxpayer in writing that an additional inspection is necessary.

### Final Determinations and Assessments.

**8007** (Law.) Sec. 1312 [of the Revenue Act of 1921]. That if after a determination and assessment in any case the taxpayer has without protest paid in whole any tax or penalty, or accepted any abatement, credit, or refund based on such determination and assessment, and an agreement is made in writing between the taxpayer and the Commissioner, with the approval of the Secretary, that such determination and assessment shall be final and conclusive, then (except upon a showing of fraud or malfeasance or misrepresentation of fact materially affecting the determination or assessment thus made) (1) the case shall not be reopened, or the determination and assessment modified by any officer, employee, or agent of the United States, and (2) no suit, action, or proceeding to annul, modify, or set aside such determination or assessment shall be entertained by any court of the United States.

### Administrative Review.

**8008** (Law.) Sec. 1313 [of the Revenue Act of 1921]. That in the absence of fraud or mistake in mathematical calculation, the findings of facts in and the decision of the Commissioner upon (or in case the Secretary is authorized to approve the same, then after such approval) the merits of any claim presented under or authorized by the internal-revenue laws shall not be subject to review by any other administrative officer, employee, or agent of the United States.



**Rules and Regulations to be Made by the Commissioner.**

**8009** (Law.) Sec. 1303 [of the Revenue Act of 1921]. That the Commissioner, with the approval of the Secretary, is hereby authorized to make all needful rules and regulations for the enforcement of the provisions of this Act.

**Swearing to Certain Returns May be Waived.**

**8010** The Commissioner, with such approval may by regulation provide that any return required by Titles\* V, VI, VII, VIII, IX, or X to be under oath may, if the amount of the tax covered thereby is not in excess of \$10, be signed or acknowledged before two witnesses instead of under oath.

\*Title V. Facilities.

Title VI. Beverages.

Title VII. Tobacco.

Title VIII. Admissions and Dues.

Title IX. Excise Taxes.

Title X. Special Taxes.

**Retroactive Regulations.**

**8011** (Law.) Sec. 1314 [of the Revenue Act of 1921]. That in case a regulation or Treasury decision relating to the internal-revenue laws made by the Commissioner or the Secretary, or by the Commissioner with the approval of the Secretary, is reversed by a subsequent regulation or Treasury decision, and such reversal is not immediately occasioned or required by a decision of a court of competent jurisdiction, such subsequent regulation or Treasury decision may, in the discretion of the Commissioner, with the approval of the Secretary, be applied without retroactive effect.

**Method of Collecting Tax.**

**8012** (Law.) Sec. 1301 [of the Revenue Act of 1921]. That whether or not the method of collecting any tax imposed by Titles \*V, VI, VII, VIII, IX, or X of this Act is specifically provided therein, any such tax may, under regulations prescribed by the Commissioner with the approval of the Secretary, be collected by stamp, coupon, serial-numbered ticket, or such other reasonable device or method as may be necessary or helpful in securing a complete and prompt collection of the tax. All administrative and penalty provisions of Title XI [Stamp Taxes], in so far as applicable, shall apply to the collection of any tax which the Commissioner determines or prescribes shall be collected in such manner.

\*Title V. Facilities.

Title VI. Beverages.

Title VII. Tobacco.

Title VIII. Admissions and Dues.

Title IX. Excise Taxes.

Title X. Special Taxes.

### Assessments.

**8013** (Law.) Sec. 1322 [of the Revenue Act of 1921]. That all internal revenue taxes, except as provided in section 250 [Income and Excess-Profits Taxes] of this Act, shall, notwithstanding the provisions of section 3182 of the Revised Statutes or any other provision of law, be assessed within four years after such taxes became due, but in the case of fraud with intent to evade tax or willful attempt in any manner to defeat or evade tax, such tax may be assessed at any time.

#### Penalty for Failure to Pay, Collect, Account for or Pay over any Tax, or for Failure to Make a Return.

**8014** (Law.) Sec. 1302 [of the Revenue Act of 1921]. (a) That any person required under Titles \*V, VI, VII, VIII, IX, X, or XII, to pay, or to collect, account for and pay over any tax, or required by law or regulations made under authority thereof to make a return or supply any information for the purposes of the computation, assessment, or collection of any such tax, who fails to pay, collect, or truly account for and pay over any such tax, make any such return or supply any such information at the time or times required by law or regulations shall in addition to other penalties provided by law be subject to a penalty of not more than \$1,000.

**8015** (b) Any person who willfully refuses to pay, collect, or truly account for and pay over any such tax, make such return or supply such information at the time or times required by law or regulation, or who willfully attempts in any manner to evade such tax, shall be guilty of a misdemeanor and in addition to other penalties provided by law shall be fined not more than \$10,000 or imprisoned for not more than one year, or both, together with the costs of prosecution.

**8016** (c) Any person who willfully refuses to pay, collect, or truly account for and pay over any such tax shall in addition to other penalties provided by law be liable to a penalty of the amount of the tax evaded, or not paid, collected, or accounted for and paid over, to be assessed and collected in the same manner as taxes are assessed and collected: *Provided, however,* That no penalty shall be assessed under this subdivision for any offense for which a penalty may be assessed under authority of section 3176 [¶8071] of the Revised Statutes, as amended, or for any offense for which a penalty has been recovered under section 3256 [Distilled Spirits] of the Revised Statutes.

**8017** (d) The term "person" as used in this section includes an officer or employee of a corporation or a member or employee of a partnership, who as such officer, employee, or member is under a duty to perform the act in respect of which the violation occurs.

- \*Title V. Facilities.
- Title VI. Beverages.
- Title VII. Tobacco.
- Title VIII. Admissions and Dues.
- Title IX. Excise Taxes.
- Title X. Special Taxes.
- Title XII. Child Labor.



**Overpayments and Overcollections of Taxes.**

**8018** (Law.) Sec. 1304 [of the Revenue Act of 1921]. That in the case of any overpayment or overcollection of any tax imposed by section 602 [Cereal beverages, etc.] or by Title V [Facilities], Title VIII [Admissions and Dues], or Title IX [Excise or sales taxes], the person making such overpayment or overcollection may take credit therefor against taxes due upon any monthly return, and shall make refund of any excessive amount collected by him upon proper application by the person entitled thereto.

**Fractional Parts of a Cent in Payment of Tax.**

**8019** (Law.) Sec. 1306 [of the Revenue Act of 1921]. That in the payment of any tax under this Act not payable by stamp a fractional part of a cent shall be disregarded unless it amounts to one-half cent or more, in which case it shall be increased to 1 cent.

**Payment of Taxes by Check or United States Securities.**

**8020** (Law.) Sec. 1325 [of the Revenue Act of 1921]. That collectors may receive, at par with an adjustment for accrued interest, notes or certificates of indebtedness issued by the United States and uncertified checks in payment of income, war-profits and excess-profits taxes and any other taxes payable other than by stamp, during such time and under such regulations as the Commissioner, with the approval of the Secretary, shall prescribe; but if a check so received is not paid by the bank on which it is drawn the person by whom such check has been tendered shall remain liable for the payment of the tax and for all legal penalties and additions the same as if such check had not been tendered.

**Articles Exported.**

**8021** (Law.) Sec. 1305 [of the Revenue Act of 1921]. That under such rules and regulations as the Commissioner with the approval of the Secretary may prescribe, the taxes imposed under the provisions of Titles VI, VII or IX shall not apply in respect to articles sold or leased for export and in due course so exported. Under such rules and regulations the amount of any internal-revenue tax erroneously or illegally collected in respect to exported articles may be refunded to the exporter of the article, instead of to the manufacturer, if the manufacturer waives any claim for the amount so to be refunded.

**Claims for Refund and Abatement of Taxes.**

**8022** (Law.) Sec. 1315 [of the Revenue Act of 1921]. That section 3220 of the Revised Statutes, as amended, is reenacted without change, as follows:

**Section 3220 of the Revised Statutes.**

**8023** "Sec. 3220. The Commissioner of Internal Revenue, subject to regulations prescribed by the Secretary of the Treasury, is authorized to remit, refund, and pay back all taxes erroneously or illegally assessed or collected, all penalties collected without authority, and all taxes that appear to be unjustly assessed or excessive in amount, or in any man-

ner wrongfully collected; also to repay to any collector or deputy collector the full amount of such sums of money as may be recovered against him in any court, for any internal revenue taxes collected by him, with the cost and expenses of suit; also all damages and costs recovered against any assessor, assistant assessor, collector, deputy collector, agent, or inspector, in any suit brought against him by reason of anything done in the due performance of his official duty, and shall make report to Congress at the beginning of each regular session of Congress of all transactions under this section."

**8024 Allowance for and redemption of Internal Revenue Stamps.—Form 46.**—The Act entitled "An Act authorizing the Commissioner of Internal Revenue to redeem or make allowance for internal revenue stamps," approved May 12, 1900, (as amended by the act of June 30, 1902 [32 stat., 506]) provides:

That the Commissioner of Internal Revenue, subject to regulations prescribed by the Secretary of the Treasury, may, upon receipt of satisfactory evidence of the facts, make allowance for or redeem such of the stamps, issued under authority of law, to denote the payment of any internal-revenue tax, as may have been spoiled, destroyed, or rendered useless or unfit for the purpose intended, or for which the owner may have no use, or which through mistake may have been improperly or unnecessarily used, or where the rates or duties represented thereby have been excessive in amount, paid in error, or in any manner wrongfully collected. Such allowance or redemption may be made, either by giving other stamps in lieu of the stamps so allowed for or redeemed, or by refunding the amount or value to the owner thereof deducting therefrom, in case of repayment, the percentage, if any, allowed to the purchaser thereof; but no allowance or redemption shall be made in any case until the stamps so spoiled or rendered useless shall have been returned to the Commissioner of Internal Revenue, or until satisfactory proof has been made showing the reason why the same cannot be returned; or, if so required by the said Commissioner, when the person presenting the same can not satisfactorily trace the history of said stamps from their issuance to the presentation of his claim as aforesaid.

\* \* \*

**8025** *Provided further,* That no claim for the redemption of or allowance for stamps shall be allowed unless presented within two years after he purchase of said stamps from the government.

\* \* \*

**8026** Sec. 2. That the finding of facts in and the decision of the Commissioner of Internal Revenue upon the merits of any claim presented under or authorized by this Act shall, in the absence of fraud or mistake in mathematical calculation, be final and not subject to revision by any accounting officer.

**8027** Sec. 3. That all laws and parts of laws in conflict with any of the provisions of this Act are hereby repealed.

**8028** **Redemption of stamps not affixed to documents or articles.**—Claims for the allowance for or redemption of unused stamps must be made on Form 46, and the facts relied upon in support of the claim should be clearly



set forth under oath. The claim should be made by the bona fide owner of the stamps presented for allowance or redemption or an agent or representative of such owner. [See page 1611.]

**8029** The claim should be supported by the certificate of the deputy collector who personally investigated the statements made by the claimant, setting forth, after careful inquiry, his belief as to the statements therein made, and by the certificate of the collector from whom the stamps were purchased, setting forth the date of purchase, by whom purchased, kind of stamps, denomination, number and amount, and his certificate that the facts set forth in the affidavit of the claimant have been carefully investigated under his direction, and his opinion as to the truth or falsity of said statements, together with such recommendation as to the allowance or disallowance of said claim as in his opinion seems just and proper.

**8030** All claims shall be forwarded to the Commissioner of Internal Revenue for examination, and he may, when he deems it necessary to complete the evidence of the facts set forth in any claim, require additional statements, certificates, or affidavits from the claimant, collector, or any other person, and may cause such investigation to be made and such instructions complied with as in his opinion are necessary to a proper adjustment of the claim.

**8031** **Redemption of stamps affixed to documents or articles.**—In cases where documentary or proprietary stamps have been affixed to instruments or articles not requiring them, and canceled, or where, by error, stamps of greater value than that required by law have been used, claims for the amounts paid in error or in excess should be made on Form 46, accompanied by the stamps, and, where practicable, by the instruments to which the stamps have been erroneously attached, or certified copies thereof. [See page 1611.] These instructions as to the use of Form 46 will also apply to cases where an instrument is duly stamped and is accidentally injured or found to be defective, and a substitute is prepared and duly stamped, or where the instrument is not used. (Extract from Regulations No. 14, Revised, published January 25, 1916.)

**8032** **Forms 46 and 47 on which to present Claims for refund and abatement of taxes.**—[See page 1611.] Claims for the refunding of assessed taxes and penalties must be made out upon Form 46. In this case, as in that of claims for abatement upon Form 47, the burden of proof rests upon the claimant. All the facts relied upon in support of the claim should be clearly set forth under oath. The claim should be still further supported by an affidavit of the deputy collector of the proper division, and by the certificate of the collector. (Extract from Regulations No. 14, Revised, published January 25, 1916.)

**8033** Claims for the abatement of taxes or penalties erroneously or illegally assessed or which are abatable under remedial acts, etc., must be made out upon Form 47, and must be sustained by the affidavits of the parties against whom the taxes were assessed, or of other parties cognizant of the facts, and must be accompanied by affidavits of the deputy collectors of the divisions in which the claims arise. (Extract from Regulation No. 14, Revised, published January 25, 1916.)

**8034 Claim for abatement stays 5% penalty until claim is rejected.—**

"When an assessment is made for a tax or penalty and demand made for payment, if a claim for abatement (Form [843]) is filed within ten days after such demand, and accepted by the collector, the time ceases to run against the claimant as to five per cent. penalty until the claim is rejected. Upon receipt of the notice of rejection of the claim, the collector should immediately notify the party assessed and demand the payment of the tax; if the tax is not then paid within ten days after mailing of the notice to the claimant by the collector of the rejection of the claim, the five per cent. penalty accrues. Interest at one per cent. per month continues to run and should be collected with the tax at the time of payment for the full number of calendar months which intervene between the date of the expiration of the first ten days' notice and the date of the payment of the tax, notwithstanding the fact that a claim for abatement has been filed." (Paragraph from Regulation No. 14, dated January 25, 1916.)

**8035 Abatement of assessments as erroneous or illegal when an equivalent amount of tax is properly due.—**

The validity of an assessment depends upon the law and actual facts existing. Therefore, an assessment made upon an erroneous theory or by mistake may not be remitted or abated because so made if, at the time its validity is passed upon, the Commissioner is in possession of evidence which shows an equivalent amount of tax is properly due in connection with the income, transaction or matter upon which the assessment is predicated. (T. D. 3251, signed by Commissioner D. H. Blair, and dated November 25, 1921.)

**Interest on Refunds and Judgments.****8036 (Law.) Sec. 1324 [of the Revenue Act of 1921]. (a) That upon the**

allowance of a claim for the refund of or credit for internal revenue taxes paid, interest shall be allowed and paid upon the total amount of such refund or credit at the rate of one-half of 1 per centum per month to the date of such allowance, as follows: (1) if such amount was paid under a specific protest setting forth in detail the basis of and reasons for such protest, from the time when such tax was paid, or (2) if such amount was not paid under protest but pursuant to an additional assessment, from the time such additional assessment was paid, or (3) if no protest was made and the tax was not paid pursuant to an additional assessment, from six months after the date of filing of such claim for refund or credit. The term "additional assessment" as used in this section means a further assessment for a tax of the same character previously paid in part.

**8037 (b) Section 177 of the Judicial Code is amended to read as follows:**

"Sec. 177. No interest shall be allowed on any claim up to the time of the rendition of judgment by the Court of Claims, unless upon a contract expressly stipulating for the payment of interest, except that interest may be allowed in any judgment of any court rendered after the passage of the Revenue Act of 1921 against the United States for any internal-revenue tax erroneously or illegally assessed or collected, or for any penalty collected without authority or any sum which was excessive or in any manner wrongfully collected, under the internal-revenue laws."



# MISCELLANEOUS LAW PROVISIONS AND REGULATIONS.

TREASURY DEPARTMENT  
INTERNAL REVENUE SERVICE  
Form No. 101, 1922  
Comptroller General U. S.  
January 15, 1922

## CLAIM FOR

- ☐ ABATEMENT OF TAX ASSESSED  
☐ CREDIT AGAINST OUTSTANDING ASSESSMENTS  
☐ REFUND OF TAXES ILLEGALLY COLLECTED  
☐ REFUND OF AMOUNTS PAID FOR STAMPS  
 USED IN ERROR OR EXCESS

### IMPORTANT

*Fits with Collector of Internal Revenue where assessment was made. Not acceptable unless completely filled in.*

State of ..... ss: \_\_\_\_\_  
 County of ..... )

### NOTICE TO COLLECTOR

Collector must indicate in black above the kind of claim, except in Income Tax cases.

Date received by  
Administrative Unit

Stamp here

COLLECTOR'S NOTATION	
District	
Account number	
Date received	
Stamp here	
Collector of Internal Revenue	

TYPE  
OR  
PRINT

(Name of taxpayer or purchaser of stamps.)

(Residence—give street and number as well as city or town and State.)

(Business address.)

This deponent, being duly sworn according to law, deposes and says that this statement is made on behalf of the taxpayer named, and that the facts given below with reference to said statement are true and complete:

- |  | PERIOD      | YEAR     |
|--|-------------|----------|
| 1. Business in which engaged .....   | From: ..... | 19.....  |
| 2. Character of assessment or tax.....<br>(State for or upon what the tax was assessed or the stamps affixed.) | To: .....   | 19.....  |
| 3. Amount of assessment or stamps purchased .....  |             | \$ ..... |
| 4. Reduction of Tax Liability requested (Income and Profits Tax) .....   |             | \$ ..... |
| 5. Amount to be abated .....   |             | \$ ..... |
| 6. Amount to be refunded (or such greater amount as is legally refundable) .....                               |             | \$ ..... |
| 7. Dates of payment (see Collector's receipts or indorsements of canceled checks) .....                        |             |          |
| (If statement covers income tax liability, items 8-11, inclusive, must be answered.)                           |             |          |
| 8. District in which return (if any) was filed .....   |             |          |
| 9. District in which unpaid assessment appears .....   |             |          |
| 10. Amount of overpayment claimed as credit .....  |             | \$ ..... |
| 11. Unpaid assessment against which credit is asked; period from .....   | to .....    | \$ ..... |

Deponent verily believes that this application should be allowed for the following reasons:

(Attach additional sheets if necessary.)

Sworn to and subscribed before me this ..... day

Signed:

of ....., 19.....

(Title)

(This affidavit may be sworn to before a Deputy Collector of Internal Revenue or Revenue Agent without charge.)

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{Page 1 of Form 843.}

MISCELLANEOUS LAW PROVISIONS AND REGULATIONS.

CERTIFICATES

I certify that an examination of the records of the Bureau of Internal Revenue shows the following facts as to the assessment and payment of the tax:

NAME OF TAXPAYER.	Character of assessment and period covered.	List	Year.	Month.	Page.	Line.	Amount.	Date paid.	District in which paid.
							\$.....		

Collector of Internal Revenue.

Assessment Clerk, Commissioner's Office.

I certify that the records of my office show the following facts as to the purchase of stamps:

TO WHOM SOLD OR ISSUED	Kind.	Number	Denomination	Date of sale or issue.	Amount.	If special tax stamp, state:	
						Serial number	Period commencing—
					\$.....		

Collector ..... District .....

Schedule Number .....

District .....

Allowed or Rejected Number .....

(Nature of tax.)

Claimant .....

Address .....

Examined and submitted for action ....., 19....

Claim examined by—

Claim approved by—

Chief of Division.

COMMITTEE ON CLAIMS

Amount claimed... \$.....  
Amount allowed... \$.....  
Amount rejected... \$.....

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9-11704



This page and page 1612 formerly carried Form 47.

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Old Form 46.—Claim for refund,  
Old Form 47.—Claim for abatement,  
Old Form 47A.—Claim for credit,  
have been superseded by  
Form 843

For which see pages 1609-1610.

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## Suits to Restrain Assessment or Collection of Taxes.

## Section 3224 of the Revised Statutes

**8038** "No suit for the purpose of restraining the assessment or collection of any tax shall be maintained in any court."

*Decision.*

(February 21, 1916.)

Supreme Court of the United States.

John F. Dodge and Horace E. Dodge, Appellants

vs.

W. H. Osborn, Commissioner of Internal Revenue.

(240 U. S. 118.)

Mr. Chief Justice White delivered the opinion of the Court.

**8039** The appellants filed their bill in the Supreme Court of the District of Columbia against the Commissioner of Internal Revenue to enjoin the assessment and collection of the taxes imposed by the Income Tax section of the Tariff Act of October 3, 1913 (38 Stat. 166, 181), and especially the surtaxes therein provided for on the ground that the statute was void for repugnancy to the Constitution of the United States. The case is here on appeal from the judgment of the court below affirming the action of the trial court in sustaining a motion to dismiss the complaint for want of jurisdiction because the complainants had an adequate remedy at law and because of the provision of section 3224 Revised Statute that "No suit for the purpose of restraining the assessment or collection of any tax shall be maintained in any court."

**8040** We at once put out of view a contention that section 3224 is not applicable to taxes imposed by the Income Tax Law since we are clearly of the opinion that it is within the contemplation of paragraph L of the act which provides:

**8041** "That all administrative, special and general provisions of law, including the laws in relation to the assessment, remission, collection, and refund of internal-revenue taxes not heretofore specifically repealed and not inconsistent with the provisions of this section, are hereby extended and made applicable to all the provisions of this section and to the tax herein imposed."

And for the same reason we do not further notice a contention as to the inapplicability of sections 3220 [¶8021], 3226 [¶8048] and 3227 [¶8049], to which effect was given by the court below requiring an appeal to the Commissioner of Internal Revenue after payment of a tax claimed to have been erroneously and illegally assessed and collected and upon his refusal to return the sum paid giving a right to sue for its recovery.

**8042** The question for decision therefore is whether the sections of the Revised Statutes referred to are controlling as to the case in hand. The plain purpose and scope of the sections are thus stated in *Snyder v. Marks*, 109 U. S. 189, 193-194, a suit brought to enjoin the collection of a revenue tax on tobacco:

"The inhibition of Section 3224 applies to all assessments of taxes, made under color of their offices, by internal revenue officers charged with general jurisdiction of the subject of assessing taxes against tobacco manufacturers.

The remedy of a suit to recover back the tax after it is paid is provided by statute, and a suit to restrain its collection is forbidden. The remedy so given is exclusive, and no other remedy can be substituted for it. *Cheatham v. United States*, 92 U. S. 85, 88, and again in *State Railroad Tax Cases*, 92 U. S. 575, 613, it was said by this court, that the system prescribed by the United States in regard to both customs duties and internal revenue taxes, of stringent measures, not judicial, to collect them, with appeals to specified tribunals, and suits to recover back moneys illegally exacted was a system of corrective justice intended to be complete, and enacted under the right belonging to the government to prescribe the conditions on which it would subject itself to the judgment of the courts in the collection of its revenues. In the exercise of that right, it declares, by section 3224, that its officers shall not be enjoined from collecting the tax claimed to have been unjustly assessed, when those officers, in the course of general jurisdiction over the subject matter in question, have made the assignment (assessment) and claim that it is valid."

And this doctrine has been repeatedly applied until it is no longer open to question that a suit may not be brought to enjoin the assessment or collection of a tax because of the alleged unconstitutionality of the statute imposing it. *Shelton v. Platt*, 139 U. S. 591; *Pittsburgh, etc., Ry. v. Board of Public Works*, 172 U. S. 32; *Pacific Whaling Company v. United States*, 187 U. S. 447, 451, 452.

**8043** But it is contended that this doctrine has no application to a case where wholly independent of any claim of the constitutionality of the tax sought to be enjoined, additional equities sufficient to sustain jurisdiction are alleged, and this, it is asserted, being such a case, falls within the exception to the general rule. But conceding for argument's sake only the legal premise upon which the contention rests, we think the conclusion that this case falls within such exception is wholly without merit, since after an examination of the complaint we are of the opinion that no ground for equitable jurisdiction is alleged. It is true the complaint contains averments that unless the taxes are enjoined many suits by other persons will be brought for the recovery of the taxes paid by them, and also that by reason of section 3187 Rev. Stat. making the tax a lien on plaintiffs' property the assessment of the taxes would constitute a cloud on plaintiffs' title. But these allegations are wholly inadequate under the hypothesis which we have assumed solely for the sake of the argument, to sustain jurisdiction, since it is apparent on their face they allege no ground for equitable relief independent of the mere complaint that the tax is illegal and unconstitutional and should not be enforced—allegations which if recognized as a basis for equitable jurisdiction would take every case where a tax assailed because of its unconstitutionality out of the provisions of the statute and thus render it nugatory, while it is obvious that the statute plainly forbids the enjoining of a tax unless by some extraordinary and entirely exceptional circumstance its provisions are not applicable.

**8044** There is a contention that the provisions requiring the appeal to the Commissioner of Internal Revenue after payment of the taxes and giving a right to sue in case of his refusal to refund are wanting in due process and therefore there is jurisdiction. But we think it suffices to state that contention to demonstrate its entire want of merit.

AFFIRMED. [240 U. S. 118]



*Decision.***Suit to Enjoin Collection of Penalties.**

District Court, N. D. Illinois, E. D.

Kohlhamer vs. Smietanka, Collector. (239 Fed. 408.)

**8045** While Section 3224 R. S. [¶8038] which prohibits suits to enjoin the collection of internal revenue taxes, does not specifically include "penalties" as such, yet where penalties are authorized by statute to be added to the tax and collected as a part of the tax, the court will hold that the penalty is a part of the tax, the assessment and collection of which are governed by Section 3224. (239 Fed. 408.)

**Fraudulent Returns.**

**8046** (Law.) Sec. 1323 [of the Revenue Act of 1921]. That section 3225 of the Revised Statutes of the United States, as amended, is re-enacted without change as follows:

**Section 3225 of the Revised Statutes.**

**8047** "Sec. 3225. When a second assessment is made in case of any list, statement, or return, which in the opinion of the collector or deputy collector was false or fraudulent, or contained any understatement or undervaluation, such assessment shall not be remitted, nor shall taxes collected under such assessment be refunded, or paid back, or recovered by any suit, unless it is proved that such list, statement, or return was not willfully false or fraudulent and did not contain any willful understatement or undervaluation."

**Limitations Upon Suits and Prosecutions.**

**8048** (Law.) Sec. 1318 [of the Revenue Act of 1921]. That section 3226 of the Revised Statutes is amended to read as follows [Sec. 3226 was further amended by the Act of March 4, 1923, by adding the matter in italics, ¶8049]:

**Section 3226 of the Revised Statutes.**

**8049** "Sec. 3226. No suit or proceeding shall be maintained in any court for the recovery of any internal-revenue tax alleged to have been erroneously or illegally assessed or collected, or of any penalty claimed to have been collected without authority, or of any sum alleged to have been excessive or in any manner wrongfully collected, until a claim for refund or credit has been duly filed with the Commissioner of Internal Revenue, according to the provisions of law in that regard, and the regulations of the Secretary of the Treasury established in pursuance thereof. No such suit or proceeding shall be begun before the expiration of six months from the date of filing such claim unless the Commissioner renders a decision thereon within that time, nor after the expiration of five years from the date of the payment of such tax, penalty, or sum, *unless such suit or proceeding is begun within two years after the disallowance of the part of such claim to which such suit or proceeding relates. The Commissioner shall within ninety days after any such disallowance notify the taxpayer thereof by mail.*"

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MISCELLANEOUS LAW PROVISIONS AND REGULATIONS.

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**8050** This section shall not affect any suit or proceeding instituted prior to the passage of this Act, but shall apply to all suits and proceedings instituted after the passage of this Act, whether or not barred by prior Acts of Congress.

**Section 3227 of the Revised Statutes Repealed.**

**8051** (Law.) Sec. 1319 [of the Revenue Act of 1921]. That section 3227 of the Revised Statutes is hereby repealed but such repeal shall not affect any suit or proceeding instituted prior to the passage of this Act.

**Five-Year Limitation on Suits.**

**8052** (Law.) Sec. 1320 [of the Revenue Act of 1921]. That no suit or proceeding for the collection of any internal revenue tax shall be begun after the expiration of five years from the time such tax was due, except in the case of fraud with intent to evade tax, or willful attempt in any manner to defeat or evade tax. This section shall not apply to suits or proceedings for the collection of taxes under section 250 [Income and Excess-Profits Taxes] of this Act, nor to suits or proceedings begun at the time of the passage of this Act.

**Limitation on Criminal Prosecutions.**

**8053** (Law.) Sec. 1321 [of the Revenue Act of 1921]. (a) That the Act entitled "An Act to limit the time within which prosecutions may be instituted against persons charged with violating internal-revenue laws" approved July 5, 1884, is amended to read as follows:

**8054** "That no person shall be prosecuted, tried, or punished for any of the various offenses arising under the internal-revenue laws of the United States unless the indictment is found or the information instituted within three years next after the commission of the offense: *Provided*, That the time during which the person committing the offense is absent from the district wherein the same is committed shall not be taken as any part of the time limited by law for the commencement of such proceedings: *Provided further*, That the provisions of this Act shall not apply to offenses committed prior to its passage: *Provided further*, That where a complaint shall be instituted before a commissioner of the United States within the period above limited, the time shall be extended until the discharge of the grand jury at its next session within the district: *And provided further*, That this Act shall not apply to offenses committed by officers of the United States."

**8055** (b) Any prosecution or proceeding under an indictment found or information instituted prior to the passage of this Act shall not be affected in any manner by this amendment, but such prosecution or proceeding shall be subject to the limitations imposed by law prior to the passage of this Act.

**Limitation on Claims for Refund or Credit.**

**8056** (Law.) Sec. 1316 [of the Revenue Act of 1921]. That section 3228 of the Revised Statutes is amended to read as follows:



## Section 3228 of the Revised Statutes.

**8057** "Sec. 3228. All claims for the refunding or crediting of any internal revenue tax alleged to have been erroneously or illegally assessed or collected, or of any penalty alleged to have been collected without authority, or of any sum alleged to have been excessive or in any manner wrongfully collected, must be presented to the Commissioner of Internal Revenue within four years next after payment of such tax, penalty, or sum."

**8058** This section, except as modified by section 252 [Income and Excess-Profits Taxes], shall apply retroactively to claims for refund under the Revenue Act of 1916, the Revenue Act of 1917, and the Revenue Act of 1918.

## Compromises.

## Section 3229 of the Revised Statutes.

**8059** "The Commissioner of Internal Revenue, with the advice and consent of the Secretary of the Treasury, may compromise any civil or criminal case arising under the internal-revenue laws instead of commencing suit thereon; and, with the advice and consent of the said Secretary and the recommendation of the Attorney General, he may compromise any such case after a suit thereon has been commenced. Whenever a compromise is made in any case there shall be placed on file in the office of the Commissioner the opinion of the Solicitor of Internal Revenue, or of the officer acting as such, with his reasons therefor, with a statement of the amount of tax assessed, the amount of additional tax or penalty imposed by law in consequence of the neglect or delinquency of the person against whom the tax is assessed, and the amount actually paid in accordance with the terms of the compromise."

## Amendments to Revised Statutes.

**8060** (Law.) Sec. 1311 [of the Revenue Act of 1921]. That sections 3164, 3165, 3167, 3172, 3173, and 3176 of the Revised Statutes, as amended, are reenacted, without change, as follows:

## Duty of Collector to Report Violations of Law to District Attorney.

## Section 3164 of the Revised Statutes.

**8061** "Sec. 3164. It shall be the duty of every collector of internal revenue having knowledge of any willful violation of any law of the United States relating to the revenue, within thirty days after coming into possession of such knowledge, to file with the district attorney of the district in which any fine, penalty, or forfeiture may be incurred, a statement of all the facts and circumstances of the case within his knowledge, together with the names of the witnesses, setting forth the provisions of law believed to be so violated on which reliance may be had for condemnation or conviction."

## Revenue Officers Who May Administer Oaths.

## Section 3165 of the Revised Statutes.

**8062** "Sec. 3165. Every collector, deputy collector, internal-revenue agent, and internal-revenue officer assigned to duty under an internal-revenue agent, is authorized to administer oaths and to take

evidence touching any part of the administration of the internal-revenue laws with which he is charged, or where such oaths and evidence are authorized by law or regulation authorized by law to be taken."

### Disclosure of Information in Returns.

**8063** "Sec. 3167. It shall be unlawful for any collector, deputy collector, agent, clerk, or other officer or employee of the United States to divulge or to make known in any manner whatever not provided by law to any person the operations, style of work, or apparatus of any manufacturer or producer visited by him in the discharge of his official duties, or the amount or source of income, profits, losses, expenditures, or any particular thereof, set forth or disclosed in any income return, or to permit any income return or copy thereof or any book containing any abstract or particulars thereof to be seen or examined by any person except as provided by law; and it shall be unlawful for any person to print or publish in any manner whatever not provided by law any income return, or any part thereof or source of income, profits, losses, or expenditures appearing in any income return; and any offense against the foregoing provision shall be a misdemeanor and be punished by a fine not exceeding \$1,000 or by imprisonment not exceeding one year, or both, at the discretion of the court; and if the offender be an officer or employee of the United States he shall be dismissed from office or discharged from employment.

### Canvass of Districts for Objects of Taxation.

#### Section 3172 of the Revised Statutes.

**8064** "Sec. 3172. Every collector shall, from time to time, cause his deputies to proceed through every part of his district and inquire after and concerning all persons therein who are liable to pay any internal revenue tax, and all persons owning or having the care and management of any objects liable to pay any tax, and to make a list of such persons and enumerate said objects."

### Annual and Other Returns.

#### Section 3173 of the Revised Statutes.

**8065** "Sec. 3173. It shall be the duty of any person, partnership, firm, association, or corporation, made liable to any duty, special tax, or other tax imposed by law, when not otherwise provided for, (1) in case of a special tax, on or before the thirty-first day of July in each year, and (2) in other cases before the day on which the taxes accrue, to make a list or return, verified by oath, to the collector or a deputy collector of the district where located, of the articles or objects, including the quantity of goods, wares, and merchandise, made or sold and charged with a tax, the several rates and aggregate amount, according to the forms and regulations to be prescribed by the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, for which such person, partnership, firm, a ssoiation, or corporation is liable:

**8066** "Provided, That if any person liable to pay any duty or tax, or owning, possessing, or having the care or management of property, goods, wares, and merchandise, articles or objects liable to pay any duty



tax, or license, shall fail to make and exhibit a list or return required by law, but shall consent to disclose the particulars of any and all the property, goods, wares, and merchandise, articles, and objects liable to pay any duty or tax, or any business or occupation liable to pay any tax as aforesaid, then, and in that case, it shall be the duty of the collector or deputy collector to make such list or return, which being distinctly read, consented to, and signed and verified by oath by the person so owning, possessing, or having the care and management as aforesaid, may be received as the list of such person:

**8067** "*Provided further*, That in case no annual list or return has been rendered by such person to the collector or deputy collector as required by law, and the person shall be absent from his or her residence or place of business at the time the collector or a deputy collector shall call for the annual list or return, it shall be the duty of such collector or deputy collector to leave at such place of residence or business, with some one of suitable age and discretion, if such be present, otherwise to deposit in the nearest post office, a note or memorandum addressed to such person, requiring him or her to render to such collector or deputy collector the list or return required by law within ten days from the date of such note or memorandum, verified by oath.

**8068** "And if any person, on being notified or required as aforesaid, shall refuse or neglect to render such list or return within the time required as aforesaid, or whenever any person who is required to deliver a monthly or other return of objects subject to tax fails to do so at theme it required, or delivers any return which, in the opinion of the collector, is erroneous, false, or fraudulent, or contains any undervaluation or understatement, or refuses to allow any regularly authorized Government officer to examine the books of such person, firm, or corporation, it shall be lawful for the collector to summon such person, or any other person having possession, custody, or care of books of account containing entries relating to the business of such person or any other person he may deem proper, to appear before him and produce such books at any time and place named in the summons, and to give testimony or answer interrogatories, under oath, respecting any objects or income liable to tax or the returns thereof.

**8069** "The collector may summon any person residing or found within the State or Territory in which his district lies; and when the person intended to be summoned does not reside and can not be found within such State or Territory, he may enter any collection district where such person may be found and there make the examination herein authorized. And to this end he may there exercise all the authority which he might lawfully exercise in the district for which he was commissioned:

**8070** "*Provided*, That 'person,' as used in this section, shall be construed to include any corporation, joint-stock company or association, or insurance company when such construction is necessary to carry out its provisions."

### Proceedings When No Return or a False Return is Made.

#### Section 3176 of the Revised Statutes.

**8071** "Sec. 3176. If any person, corporation, company, or association fails to make and file a return or list at the time prescribed by law or by regulation made under authority of law, or makes, willful

otherwise, a false or fraudulent return or list, the collector or deputy collector shall make the return or list from his own knowledge and from such information as he can obtain through testimony or otherwise. In any such case the Commissioner may, from his own knowledge and from such information as he can obtain through testimony or otherwise, make a return or amend any return made by a collector or deputy collector. Any return or list so made and subscribed by the Commissioner, or by a collector or deputy collector and approved by the Commissioner, shall be prima facie good and sufficient for all legal purposes.

**8072** "If the failure to file a return or list is due to sickness or absence, the collector may allow such further time, not exceeding thirty days, for making and filing the return or list as he deems proper.

**8073** "The Commissioner of Internal Revenue shall determine and assess all taxes, other than stamp taxes, as to which returns or lists are so made under the provisions of this section. In case of any failure to make and file a return or list within the time prescribed by law, or prescribed by the Commissioner of Internal Revenue or the collector in pursuance of law, the Commissioner of Internal Revenue shall add to the tax 25 per centum of its amount, except that when a return is filed after such time and it is shown that the failure to file it was due to a reasonable cause and not to willful neglect, no such addition shall be made to the tax. In case a false or fraudulent return or list is willfully made, the Commissioner of Internal Revenue shall add to the tax 50 per centum of its amount.

**8074** "The amount so added to any tax shall be collected at the same time and in the same manner and as part of the tax unless the tax has been paid before the discovery of the neglect, falsity, or fraud, in which case the amount so added shall be collected in the same manner as the tax."

#### Deposit of United States Bonds or Notes in Lieu of Surety.

**8075** (Law.) Sec. 1329 [of the Revenue Act of 1921]. That wherever by the laws of the United States or regulations made pursuant thereto, any person is required to furnish any recognizance, stipulation, bond, guaranty, or undertaking, hereinafter called "penal bond," with surety or sureties, such person may, in lieu of such surety or sureties, deposit as security with the official having authority to approve such penal bond, United States Liberty bonds or other bonds or notes of the United States in a sum equal at their par value to the amount of such penal bond required to be furnished, together with an agreement authorizing such official to collect or sell such bonds or notes so deposited in case of any default in the performance of any of the conditions or stipulations of such penal bond. The acceptance of such United States bonds or notes in lieu of surety or sureties required by law shall have the same force and effect as individual or corporate sureties, or certified checks, bank drafts, post-office money orders, or cash, for the penalty or amount of such penal bond. The bonds or notes deposited hereunder and such other United States bonds or notes as may be substituted therefor from time to time as such security, may be deposited with the Treasurer of the United States, a Federal reserve bank, or other depository duly designated for that purpose by the Secretary, which shall issue receipt therefor, describing such bonds or notes so deposited. As soon as security for the performance of such penal bond is no longer necessary, such bonds or notes so deposited, shall be returned to the depositor: *Provided*, That in case



a person or persons supplying a contractor with labor or material as provided by the Act of Congress, approved February 24, 1905 (33 Stat. 811), entitled "An Act to amend an Act approved August thirteenth, eighteen hundred and ninety-four, entitled 'An Act for the protection of persons furnishing materials and labor for the construction of public works,' " shall file with the obligee, at any time after a default in the performance of any contract subject to said Acts, the application and affidavit therein provided, the obligee shall not deliver to the obligor the deposited bonds or notes nor any surplus proceeds thereof until the expiration of the time limited by said Acts for the institution of suit by such person or persons, and, in case suit shall be instituted within such time, shall hold said bonds or notes or proceeds subject to the order of the court having jurisdiction thereof: *Provided further*, That nothing herein contained shall affect or impair the priority of the claim of the United States against the bonds or notes deposited or any right or remedy granted by said Acts or by this section to the United States for default upon any obligation of said penal bond: *Provided further*, That all laws inconsistent with this section are hereby so modified as to conform to the provisions hereof: *And provided further*, That nothing contained herein shall affect the authority of courts over the security, where such bonds are taken as security in judicial proceedings, or the authority of any administrative officer of the United States to receive United States bonds for security in cases authorized by existing laws. The Secretary may prescribe rules and regulations necessary and proper for carrying this section into effect.

#### **Prior Acts and Parts of Acts Repealed.**

**8076** (Law.) Sec. 1400 [of the Revenue Act of 1921]. (a) That the following parts of the Revenue Act of 1918 are repealed, to take effect (except as otherwise provided in this Act) on January 1, 1922, subject to the limitations provided in subdivision (b):

Title II (called "Income Tax") as of January 1, 1921;

Title III (called "War-Profits and Excess-Profits Tax") as of January 1, 1921;

Title IV (called "Estate Tax") on the passage of this Act;

Title V (called "Tax on Transportation and other Facilities, and on Insurance");

Sections 628, 629, and 630 of Title VI (being the taxes on soft drinks, ice cream, and similar articles);

Title VII (called "Tax on Cigars, Tobacco and Manufactures Thereof");

Title VIII (called "Tax on Admissions and Dues");

Title IX (called "Excise Taxes");

Title X (called "Special Taxes");

Title XI (called "Stamp Taxes");

Title XII (called "Tax on Employment of Child Labor") as of January 1, 1921; and

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Sections 1314, 1315, 1316, 1317, 1319, and 1320 of Title XIII (being certain administrative provisions) on the passage of this Act.

### Extent to which Prior Acts or Parts of Acts Remain in Force.

**8077** (b) The parts of the Revenue Act of 1918 which are repealed by this Act shall (unless otherwise specifically provided in this Act) remain in force for the assessment and collection of all taxes which have accrued under the Revenue Act of 1918 at the time such parts cease to be in effect, and for the imposition and collection of all penalties or forfeitures which have accrued or may accrue in relation to any such taxes. In the case of any tax imposed by any part of the Revenue Act of 1918 repealed by this Act, if there is a tax imposed by this Act in lieu thereof, the provision imposing such tax shall remain in force until the corresponding tax under this Act takes effect under the provisions of this Act. The unexpended balance of any appropriation heretofore made and now available for the administration of any such part of the Revenue Act of 1918 shall be available for the administration of this Act or the corresponding provision thereof.

### Short Titles.

#### Revenue Act of 1916.

**8078** (Law.) Sec. 1403 [of the Revenue Act of 1918]. That the Revenue Act of 1916 is hereby amended by adding at the end thereof a section to read as follows:

**8079** "Sec. 903. That this Act may be cited as the 'Revenue Act of 1916.'"

#### Revenue Act of 1917.

**8080** (Law.) Sec. 1404 [of the Revenue Act of 1918]. That the Revenue Act of 1917 is hereby amended by adding at the end thereof a section to read as follows:

**8081** "Sec. 1303. That this Act may be cited as the 'Revenue Act of 1917.'"

#### Revenue Act of 1918.

**8082** (Law.) Sec. 1405 [of the Revenue Act of 1918]. That this Act may be cited as the "Revenue Act of 1918."

#### Revenue Act of 1921.

**8083** (Law.) Sec. 1 [of the Revenue Act of 1921]. That this Act may be cited as the "Revenue Act of 1921."

### General Definitions.

**8084** (Law.) Sec. 2 [of the Revenue Act of 1921]. That when used in this Act—

**8085** (1) The term "person" includes partnerships and corporations, as well as individuals;



## MISCELLANEOUS LAW PROVISIONS AND REGULATIONS.

- 8086** (2) The term "corporation" includes associations, joint-stock companies, and insurance companies;
- 8087** (3) The term "domestic" when applied to a corporation or partnership means created or organized in the United States;
- 8088** (4) The term "foreign" when applied to a corporation or partnership means created or organized outside the United States;
- 8089** (5) The term "United States" when used in a geographical sense includes only the States, the Territories of Alaska and Hawaii, and the District of Columbia;
- 8090** (6) The term "Secretary" means the Secretary of the Treasury;
- 8091** (7) The term "Commissioner" means the Commissioner of Internal Revenue;
- 8092** (8) The term "collector" means collector of internal revenue;
- 8093** (9) The term "taxpayer" includes any person, trust or estate subject to a tax imposed by this Act.
- 8094** (10) The term "military or naval forces of the United States" includes the Marine Corps, the Coast Guard, the Army Nurse Corps, Female, and the Navy Nurse Corps, Female, but this shall not be deemed to exclude other units otherwise included within such terms; and
- 8095** (11) The term "government contract" means (a) a contract made with the United States, or with any department, bureau, officer, commission, board, or agency, under the United States and acting in its behalf, or with any agency controlled by any of the above if the contract is for the benefit of the United States, or (b) a subcontract made with a contractor performing such a contract if the products or services to be furnished under the subcontract are for the benefit of the United States. The term "government contract or contracts made between April 6, 1917, and November 11, 1918, both dates inclusive" when applied to a contract of the kind referred to in clause (a) of this subdivision, includes all such contracts which, although entered into during such period, were originally not enforceable, but which have been or may become enforceable by reason of subsequent validation in pursuance of law.

## Saving Clause in Event of Unconstitutionality.

- 8096** (Law.) Sec. 1403 [of the Revenue Act of 1921]. That if any provision of this Act, or the application thereof to any person or circumstances, is held invalid, the remainder of the Act, and the application of such provision to other persons or circumstances, shall not be affected thereby.

## General Effective Date of Act.

- 8097** (Law.) Sec. 1404 [of the Revenue Act of 1921]. That except as otherwise provided, this Act shall take effect upon its passage.

Approved by the President, November 23, 1921, at 3:55 P. M.

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WAR TAX 1623 SERVICE

(Decision.)

Revised Statutes Section 3226.

On the running of the statute of limitations on appeals to the Commissioner for abatement or refund as the step precedent to suit for recovery:

A preliminary request of the Commissioner for an informal ruling is in no sense a claim for abatement or refund.

## SUPREME COURT OF THE UNITED STATES

Baltimore and Ohio Railroad Company,	}	Appeal from the Court of Claims.
Appellant,		
<i>vs.</i>		
The United States.		

[January 2, 1923.]

Mr. Justice SUTHERLAND delivered the opinion of the Court.

**8098** The appellant brought an action in the Court of Claims against  
 8024 the United States to recover the sum of \$55,158.00, alleged to have  
 8049 been illegally exacted as stamp taxes upon thirteen deeds of conveyance made and delivered to appellant by its subsidiary companies. The deeds were without valuable consideration and were executed for the sole purpose of transferring legal title to enable appellant to mortgage the property conveyed. On February 11, 1915, before the delivery of these deeds, appellant exhibited three of them to the Commissioner of Internal Revenue and asked for a ruling, thereby making what it alleges was a claim in abatement. The Commissioner held that the Stamp Tax Act applied, and the appellant, without protest, affixed to the thirteen deeds the requisite amount of stamps.

**8099** Four years later the Commissioner, in construing a similar act of 1918 held that "where no valuable consideration passed stamps were not required on conveyances."

**8100** Appellant thereupon filed with the Commissioner a claim for refund of the taxes paid which was rejected because barred by the statute of limitations.

**8101** Appellant now alleges that its claim for a refund constitutes an amendment of its original so-called claim in abatement. The Court of Claims sustained a demurrer to appellant's petition alleging the foregoing upon the ground that the original request to the Commissioner for a ruling was not a claim either for abatement or refund, but that the claim for a refund was in effect first made in 1919, and, therefore, that the Commissioner's ruling was right.

**8102** The Act of May 12, 1900 c. 393, 31 Stat. 177, as amended by the Act of June 30, 1902 c. 1327, 32 Stat. 506, provides in part:

"That the Commissioner of Internal Revenue, subject to regulations prescribed by the Secretary of the Treasury, may, upon receipt of satisfactory evidence of the facts, make allowance for or redeem such of the stamps, issued under authority of law, to denote the payment of any internal-



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 MISCELLANEOUS LAW PROVISIONS AND REGULATIONS.
 

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revenue tax, as may have been spoiled . . . or in any manner wrongfully collected. . . . Provided further, that no claim for the redemption of or allowance for stamps shall be allowed unless presented within two years after the purchase of said stamps from the Government."

**8103** By Section 3226 Revised Statutes [¶8049] no suit can be maintained in any court for the recovery of any internal revenue tax alleged to have been erroneously or illegally collected until appeal has been made to the Commissioner of Internal Revenue, as provided by law, and the decision of the Commissioner thereon has been had.

**8104** The preliminary request to the Commissioner for an informal ruling was in no sense a claim for abatement or refund. Appellant affixed the stamps to the deeds without protest and after that no effort was made to secure redemption of or allowance for the stamps until long after the two-year period had expired.

**8105** On the facts alleged in the petition the Court of Claims could not have done otherwise than sustain the demurrer. *Rock Island, Arkansas and Louisiana Railway Company v. United States*, 254 U. S. 141.

**8106** The judgment of the Court of Claims is

*Affirmed.*

[The foregoing decision has been reproduced by the Government in T. D. 3430, dated Jan. 19, 1923.]











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Reproduced in this Service.

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# INTERNAL REVENUE COLLECTION DISTRICTS

Including

NAMES AND ADDRESSES OF COLLECTORS AND LOCATION OF  
BRANCH OFFICES.

(Corrected to June 19, 1923.)

**ALABAMA** (Comprising the State of Alabama),  
Collector: William E. Snead, Birmingham.  
Div. Hdqrs. at: Mobile, Montgomery.

**ALASKA** (See Washington).

**ARIZONA** (Comprising the State of Arizona),  
Collector: Frank R. Stewart, Phoenix.

**ARKANSAS** (Comprising the State of Arkansas),  
Collector: Harmon L. Remmel, Little Rock.  
Div. Hdqrs. at: Fort Smith, Helena.

## CALIFORNIA

First District.—Comprising the following counties in California: Alameda, Alpine, Amador, Butte, Calaveras, Clousa, Contra Costa, Del Norte, Eldorado, Fresno, Glenn, Humboldt, Inyo, Kings, Lake, Lassen, Madera, Marin, Mariposa, Mendocino, Merced, Modoc, Mono, Monterey, Napa, Nevada, Placer, Plumas, Sacramento, San Benito, San Francisco, San Joaquin, San Mateo, Santa Clara, Santa Cruz, Shasta, Sierra, Siskiyou, Solano, Sonoma, Stanislaus, Sutter, Tulare, Tehama, Trinity, Tuolumne, Yolo and Yuba.

Collector: John P. McLaughlin, San Francisco.  
Div. Hdqrs. at: Sacramento,\* Oakland,\* Stockton.  
Stamp Office at: Fresno.

Sixth District.—Comprising that part of California included in the following counties: Imperial, Kern, Los Angeles, Orange, Riverside, San Bernardino, San Diego, San Luis Obispo, Santa Barbara and Ventura.

Collector: Rex B. Goodcell, Los Angeles.  
Div. Hdqrs. at: San Diego,\* San Bernardino, Santa Barbara.

**COLORADO** (Comprising the State of Colorado),  
Collector: Frank W. Howbert, Denver.

**CONNECTICUT** (Comprising the State of Connecticut),  
Collector: Robert O. Eaton, Hartford.  
Div. Hdqrs. at: Bridgeport,\* New Haven,\* Waterbury, New London.

**DELAWARE** (Comprising the State of Delaware),  
Collector: John W. Hering, Wilmington.

**DISTRICT OF COLUMBIA** (See Maryland).

**FLORIDA** (Comprising the State of Florida),  
Collector: Daniel T. Gerow, Jacksonville.  
Div. Hdqrs. at: Tampa,\* Pensacola, Miami.  
Stamp Office at: Key West.

**GEORGIA** (Comprising the State of Georgia),  
Collector: Josiah T. Rose, Atlanta.  
Div. Hdqrs. at: Macon and Savannah.

**HAWAII** (Comprising the Territory of Hawaii),  
Collector: J. Walter Jones, Honolulu.  
Stamp Office at: Hilo.

\*Stamps sold.

## FORMS, FINDER, ETC.

**IDAHO** (Comprising the State of Idaho),  
Collector: Evan Evans, Boise.  
Div. Hdqrs. at: Pocatello.

### ILLINOIS

**First District.**—Comprising that part of the State of Illinois included in the following counties: Boone, Bureau, Carroll, Cook, DeKalb, Dupage, Grundy, Henderson, Henry, Jo Daviess, Kane, Kankakee, Kendall, Knox, Lake, LaSalle, Lee, McHenry, Marshall, Mercer, Ogle, Peoria, Putnam, Rock Island, Stark, Stephenson, Warren, Whiteside, Will, and Winnebago.

Collector: Mrs. Mabel Gilmore Reinecke, Chicago.  
Div. Hdqrs. at: Chicago (five), Joliet, Rock Island,\* Peoria,\* Rockford, Aurora.

**Eight District.**—Comprising that part of the State of Illinois included in the following counties: Adams, Alexander, Bond, Brown, Calhoun, Cass, Champaign, Christian, Clark, Clay, Clinton, Coles, Crawford, Cumberland, Dewitt, Douglas, Edgar, Edwards, Effingham, Fayette, Ford, Franklin, Fulton, Gallatin, Greene, Hamilton, Hancock, Hardin, Iroquois, Jackson, Jasper, Jefferson, Jersey, Johnson, Lawrence, Livingston, Logan, McDonough, McLean, Macon, Macoupin, Madison, Marion, Mason, Massac, Menard, Monroe, Montgomery, Morgan, Moultrie, Perry, Platt, Pike, Pope, Pulaski, Randolph, Richland, St. Clair, Saline, Sangamon, Schuyler, Scott, Shelby, Tazewell, Union, Vermilion, Wabash, Washington, Wayne, White, Williamsor, and Woodford.

Collector: George W. Schwaner, Springfield.  
Div. Hdqrs. at: East St. Louis,\* Cairo, Centralia, Danville,\* Decatur,\*  
Bloomington, Quincy.\*  
Stamp Offices at: Pekin, Jacksonville, Canton.

**INDIANA** (Comprising the State of Indiana),  
Collector: M. Bert Thurman, Indianapolis.  
Div. Hdqrs. at: Gary, South Bend,\* Ft. Wayne,\* Logansport, Lafayette,\*  
Muncie, New Albany, Evansville,\* Terre Haute.\*  
Stamp Office at: Lawrenceburg.

**IOWA** (Comprising the State of Iowa),  
Collector: Lars E. Bladine, Dubuque.  
Div. Hdqrs. at: Davenport,\* Des Moines,\* Ottumwa,\* Sioux City,\* Cedar  
Rapids, Council Bluffs, Mason City.  
Stamp Office at: Burlington.

**KANSAS** (Comprising the State of Kansas),  
Collector: Harvey H. Motter, Wichita.  
Div. Hdqrs. at: Kansas City,\* Parsons, Topeka, Salina.

**KENTUCKY** (Comprising the State of Kentucky),  
Collector: Robert H. Lucas, Louisville.  
Div. Hdqrs. at: Ashland, Paducah,\* Owensboro,\* Lexington,\* Covington.\*  
Stamp Offices at: Danville, Frankfort.

**LOUISIANA** (Comprising the State of Louisiana),  
Collector: D. Arthur Lines, New Orleans.  
Div. Hdqrs. at: Shreveport, Baton Rouge.

**MAINE** (Comprising the State of Maine),  
Collector: Frank J. Ham, Augusta.  
Div. Hdqrs. at: Portland, Bangor.

**MARYLAND** (Comprising the State of Maryland and the District of Columbia),  
Collector: Galen L. Tait, Baltimore.  
Div. Hdqrs. at: Washington, D. C.,\* Hagerstown, Salisbury.

\*Stamps sold.



## FORMS, FINDER, ETC.

**MASSACHUSETTS** (Comprising the State of Massachusetts),

Collector: Malcolm E. Nichols, Boston.

Div. Hdqrs. at: Springfield, Worcester, Fall River, Lawrence.

**MICHIGAN**

**First District.**—Comprising that part of the State of Michigan included in the following counties: Alcona, Alpena, Arenac, Bay, Branch, Calhoun, Cheboygan, Clare, Clinton, Crawford, Genesee, Gladwin, Gratiot, Hillsdale, Huron, Ingham, Iosco, Isabella, Jackson, Lapeer, Lenawee, Livingston, Macomb, Midland, Monroe, Montgomery, Oakland, Ogemaw, Oscoda, Otsego, Presque Isle, Roscommon, Saginaw, Sanilac, Shiawassee, St. Clair, Tuscola, Washtenaw, and Wayne.

Collector: Fred L. Woodworth, Detroit.

Div. Hdqrs. at: Bay City,\* Jackson, Flint.

Stamp Office at: Saginaw.

**Fourth District.**—Comprising that part of that State of Michigan included in the following counties: Alger, Allegan, Antrim, Baraga, Barry, Benzle, Berrien, Cass, Charlevoix, Chippewa, Delta, Dickinson, Eaton, Emmet, Gogebic, Grand Traverse, Houghton, Ionia, Iron, Kalamazoo, Kalaskas, Kent, Keweenaw, Lake, Leelanau, Luce, Mackinac, Manistee, Marquette, Mason, Mecosta, Menominee, Missaukee, Montcalm, Muskegon, Newaygo, Oceana, Ontonagon, Osceola, Ottawa, St. Joseph, Schoolcraft, Van Buren, and Wexford.

Collector: Charles Holden, Grand Rapids.

Div. Hdqrs. at: Kalamazoo, Marquette.

**MINNESOTA** (Comprising the State of Minnesota),

Collector: Levi M. Willcuts, St. Paul.

Div. Hdqrs. at: Minneapolis,\* Duluth,\* Winona, Mankato, St. Cloud.

**MISSISSIPPI** (Comprising the State of Mississippi),

Collector: George L. Donald, Jackson.

Div. Hdqrs. at: Meridan, Greenwood.

**MISSOURI**

**First District.**—Comprising that part of the State of Missouri included in the following counties: Adair, Audrain, Bollinger, Boone, Butler, Callaway, Cape Girardeau, Carter, Clark, Crawford, Dent, Dunklin, Franklin, Gasconade, Howard, Iron, Jefferson, Knox, Lewis, Lincoln, Linn, Macon, Madison, Maries, Marion, Mississippi, Montgomery, Monroe, New Madrid, Oregon, Osage, Pemiscot, Perry, Phelps, Pike, Pulaski, Rails, Randolph, Reynolds, Ripley, St. Charles, St. Francois, Ste. Genevieve, St. Louis, Schuyler, Scotland, Scott, Shannon, Shelby, Stoddard, Warren, Washington, and Wayne.

Collector: Arnold J. Hellmich, St. Louis.

Div. Hdqrs. at: Hannibal, Cape Girardeau.

**Sixth District.**—Comprising that part of the State of Missouri included in the following counties: Andrew, Atchison, Benton, Barry, Barton, Bates, Buchanan, Caldwell, Camden, Carroll, Cass, Cedar, Charlton, Christian, Clay, Clinton, Cole, Cooper, Dade, Dallas, Daviess, Dekalb, Douglas, Gentry, Greene, Grundy, Harrison, Henry, Hickory, Holt, Howell, Jackson, Jasper, Johnson, Laclede, Lafayette, Lawrence, Livingston, McDonald, Mercer, Miller, Moniteau, Morgan, Newton, Nodaway, Ozark, Pettis, Platte, Polk, Putnam, Ray, St. Clair, Saline, Stone, Sullivan, Taney, Texas, Vernon, Webster, Worth, and Wright.

Collector: Noah Crooks, Kansas City.

Div. Hdqrs. at: St. Joseph,\* Springfield.

Stamp Office at: Joplin.

**MONTANA** (Comprising the State of Montana),

Collector: Charles A. Rasmusson, Helena.

Div. Hdqrs. at: Butte,\* Great Falls, Billings.

**NEBRASKA** (Comprising the State of Nebraska),

Collector: Arthur B. Allen, Omaha.

Div. Hdqrs. at: Lincoln, Grand Island.

**NEVADA** (Comprising the State of Nevada),

Collector: Louis A. Spellier, Reno.

**NEW HAMPSHIRE** (Comprising the State of New Hampshire),

Collector: John H. Field, Portsmouth.

Stamp Office at: Manchester.

\*Stamps sold.

## FORMS, FINDER, ETC.

### NEW JERSEY

**First District.**—Comprising that part of the State of New Jersey included in the following counties: Atlantic, Burlington, Camden, Cape May, Cumberland, Gloucester, Mercer, Monmouth, Ocean, and Salem.

**Collector:** Edward L. Sturgess, Camden.

**Div. Hdqrs. at:** Trenton.

**Fifth District.**—Comprising that part of the State of New Jersey included in the following counties: Bergen, Essex, Hudson, Hunterdon, Middlesex, Morris, Passaic, Somerset, Sussex, Union, Warren.

**Collector:** Frank C. Ferguson, Newark.

**Div. Hdqrs. at:** Jersey City,\* Paterson,\* Elizabeth, Morristown.

**Stamp Office at:** New Brunswick.

### NEW MEXICO (Comprising the State of New Mexico),

**Collector:** Benigno C. Hernandez, Albuquerque.

### NEW YORK

**First District.**—Comprising that part of the State of New York included in the following counties: Kings, Nassau, Queens, Richmond, and Suffolk.

**Collector:** John T. Rafferty, Brooklyn.

**Div. Hdqrs. at:** Patchogue.

**Second District.**—Comprising that part of the County of New York, N. Y., lying south of the south side of 23d Street.

**Collector:** Frank K. Bowers, Custom House, New York.

**Div. Hdqrs. at:** 119 E. 14th Street.

**Third District.**—Comprising that part of the County of New York, N. Y., lying north of the south side of 23d Street, and those three certain islands situated in the East River known as Randall's Island, Ward's Island and Blackwell's Island.

**Collector:** Charles W. Anderson, 250 W. 57th Street.

**Div. Hdqrs. at:** 1416 Broadway, 1819 Broadway,\* 310 Lenox Ave.

**Stamp Office at:** San Juan, P. R.

**Fourteenth District.**—Comprising that part of the State of New York included in the following counties: Albany, Bronx (formerly the 23rd and 24th wards of New York City), Clinton, Columbia, Dutchess, Essex, Fulton, Greene, Hamilton, Montgomery, Orange, Putnam, Rensselaer, Rockland, Saratoga, Schenectady, Schoharie, Sullivan, Ulster, Warren, Washington, and Westchester.

**Collector:** Cyrus Durey, Albany.

**Div. Hdqrs. at:** Schenectady, Troy, Newburgh, Bronx,\* 1932 Arthur Ave., N. Y. City, Poughkeepsie.

**Stamp Office at:** Peekskill.

**Twenty-first District.**—Comprising that part of New York included in the following counties: Broome, Cayuga, Chenango, Cortland, Delaware, Franklin, Herkimer, Jefferson, Lewis, Madison, Oneida, Onondaga, Oswego, Otsego, St. Lawrence, Schuyler, Seneca, Tioga, Tompkins, and Wayne.

**Collector:** Jesse W. Clarke, Syracuse.

**Div. Hdqrs. at:** Utica,\* Binghamton,\* Watertown.

**Twenty-eight District.**—Comprising that part of New York included in the following counties: Allegany, Cattaraugus, Chautauqua, Chemung, Erie, Genesee, Livingston, Monroe, Niagara, Ontario, Orleans, Steuben, Wyoming, and Yates.

**Collector:** Bert P. Gage, Buffalo.

**Div. Hdqrs. at:** Rochester,\* Elmira,\* Jamestown.

### NORTH CAROLINA (Comprising the State of North Carolina),

**Collector:** Gilliam Grissom, Raleigh.

**Div. Hdqrs. at:** Washington, Wilmington, Charlotte, Asheville, Winston-Salem.\*

**Stamp Offices at:** Durham, Reidsville, Statesville, Greensboro.

### NORTH DAKOTA (Comprising the State of North Dakota),

**Collector:** Gunder Olson, Fargo.

**Div. Hdqrs. at:** Grand Forks.

\*Stamps sold.



## FORMS, FINDER, ETC.

## OHIO

**First District.**—Comprising that part of the State of Ohio included in the following counties: Brown, Butler, Clarke, Clermont, Clinton, Fayette, Greene, Hamilton, Highland, Miami, Montgomery, Preble, and Warren.

Collector: Charles M. Dean, Cincinnati.

Div. Hdqrs. at: Dayton.\*

Stamp Offices at: Middletown, Hamilton.

**Tenth District.**—Comprising that part of the State of Ohio included in the following counties: Allen, Auglaize, Champaign, Crawford, Darke, Defiance, Erie, Fulton, Hancock, Hardin, Henry, Huron, Logan, Lucas, Mercer, Ottawa, Paulding, Putnam, Sandusky, Seneca, Shelby, Van Wert, Williams, Wood, and Wyandot.

Collector: Charles H. Nauts, Toledo.

**Eleventh District.**—Comprising that part of the State of Ohio included in the following counties: Adams, Athens, Coshocton, Delaware, Fairfield, Franklin, Gallia, Guernsey, Hocking, Jackson, Knox, Lawrence, Licking, Madison, Marion, Meigs, Morgan, Morrow, Muskingum, Noble, Perry, Pickaway, Pike, Ross, Scioto, Union, Vinton, and Washington.

Collector: Newton M. Miller, Columbus.

Div. Hdqrs. at: Portsmouth, Zanesville.

**Eighteenth District.**—Comprising that part of the State of Ohio included in the following counties: Ashland, Ashtabula, Belmont, Carroll, Columbiana, Cuyahoga, Geauga, Harrison, Holmes, Jefferson, Lake, Lorain, Mahoning, Medina, Monroe, Portage, Richland, Stark, Summit, Trumbull, Tuscarawas, and Wayne.

Collector: Carl F. Routzahn, Cleveland.

Div. Hdqrs. at: Akron, Canton, Youngstown, Steubenville.

**OKLAHOMA** (Comprising the State of Oklahoma),

Collector: Acel C. Alexander, Oklahoma City.

Div. Hdqrs. at: Tulsa, Muskogee, McAlester, Enid.

**OREGON** (Comprising the State of Oregon),

Collector: Clyde G. Huntley, Portland.

Div. Hdqrs. at: Eugene, Pendleton.

## PENNSYLVANIA

**First District.**—Comprising that part of the State of Pennsylvania included in the following counties: Adams, Bedford, Berks, Blair, Bucks, Chester, Cumberland, Dauphin, Delaware, Franklin, Fulton, Huntingdon, Juniata, Lancaster, Lebanon, Lehigh, Mifflin, Montgomery, Perry, Philadelphia, Schuylkill, Snyder, and York.

Collector: Blakely D. McCaughn, Philadelphia.

Div. Hdqrs. at: Philadelphia (2), Allentown,\* Altoona, Chester, Harrisburg,\* Lancaster,\* Norristown, Pottsville,\* Reading,\* York.\*

**Twelfth District.**—Comprising that part of the State of Pennsylvania included in the following counties: Bradford, Carbon, Center, Clinton, Columbia, Lackawanna, Luzerne, Lycoming, Monroe, Montour, Northampton, Northumberland, Pike, Potter, Sullivan, Susquehanna, Tioga, Union, Wayne, Wyoming.

Collector: David W. Phillips, Scranton.

Div. Hdqrs. at: Wilkesbarre,\* Easton,\* Shamokin.

**Twenty-third District.**—Comprising that part of the State of Pennsylvania included in the following counties: Allegheny, Armstrong, Beaver, Butler, Cambria, Cameron, Clarion, Clearfield, Crawford, Elk, Erie, Fayette, Forest, Green, Indiana, Jefferson, Lawrence, McKean, Mercer, Venango, Warren, Washington, and Westmoreland.

Collector: Daniel B. Heiner, Pittsburgh.

Div. Hdqrs. at: Erie,\* Uniontown,\* New Castle, Du Bois, Johnstown.

**RHODE ISLAND** (Comprising the State of Rhode Island),

Collector: Frank A. Page, Providence.

**SOUTH CAROLINA** (Comprising the State of South Carolina),

Collector: John F. Jones, Columbia.

**SOUTH DAKOTA** (Comprising the State of South Dakota),

Collector: Leslie Jensen, Aberdeen.

Div. Hdqrs. at: Sioux Falls.

**TENNESSEE** (Comprising the State of Tennessee),

Collector: Louis P. Brewer, Nashville.

Div. Hdqrs. at: Memphis,\* Chattanooga,\* Knoxville.\*

\*Stamps sold.

## FORMS, FINDER, ETC.

### TEXAS

**First District.**—Comprising that part of the State of Texas included in the following counties: Aransas, Atascosa, Austin, Bandera, Bastrop, Bee, Bell, Bexar, Blanco, Bosque, Brazoria, Brazos, Brewster, Brooks, Burleson, Burnet, Caldwell, Calhoun, Cameron, Chambers, Colorado, Comal, Coryell, Culberson, Dewitt, Dimmit, Dunn, Duval, Edwards, El Paso, Falls, Fayette, Fort Bend, Freestone, Frio, Galveston, Gillespie, Goliad, Gonzales, Grimes, Guadalupe, Hamilton, Hardin, Harris, Hays, Hidalgo, Hill, Hudspeth, Jackson, Jasper, Jeff Davis, Jefferson, Jim Hogg, Jim Wells, Karnes, Kendall, Kerr, Kimble, Kinney, Kleberg, Lampasas, La Salle, Lavaca, Lee, Leon, Liberty, Limestone, Live Oak, Llano, McCulloch, McLennan, McMullen, Madison, Mason, Matagorda, Maverick, Medina, Milam, Montgomery, Newton, Nueces, Orange, Pecos, Polk, Presidio, Real, Reeves, Refugio, Robertson, San Jacinto, San Patricio, San Saba, Somervell, Starr, Terrell, Travis, Trinity, Tyler, Uvalde, Val Verde, Victoria, Walker, Waller, Washington, Webb, Wharton, Willacy, Williamson, Wilson, Zapata, and Zavalla.

Collector: James W. Bass, Austin.

Div. Hdqrs. at: San Antonio,\* Houston,\* El Paso, Waco.\*

**Second District.**—Comprising that part of the State of Texas included in the following counties: Anderson, Andrews, Angelina, Archer, Armstrong, Bailey, Baylor, Borden, Bowie, Briscoe, Brown, Callahan, Camp, Carson, Cass, Castro, Cherokee, Childress, Clay, Cochran, Coke, Coleman, Collin, Collingsworth, Comanche, Concho, Cooke, Cottle, Crane, Crockett, Crosby, Dallam, Dallas, Dawson, Deaf Smith, Delta, Denton, Dickens, Donley, Eastland, Ector, Ellis, Erath, Fannin, Fisher, Floyd, Foard, Franklin, Gaines, Garza, Glasscock, Gray, Grayson, Gregg, Hale, Hall, Hansford, Hardeman, Harrison, Hartley, Haskell, Hemphill, Henderson, Hockley, Hood, Hopkins, Houston, Howard, Hunt, Hutchinson, Irion, Jack, Johnson, Jones, Kaufman, Kent, King, Knox, Lamar, Lamb, Lipscomb, Loving, Lubbock, Lynn, Marion, Martin, Menard, Midland, Mills, Mitchell, Montague, Moore, Morris, Motley, Nacogdoches, Navarro, Nolan, Ochiltree, Oldham, Palo Pinto, Panola, Parker, Parmer, Potter, Rains, Randall, Reagan, Red River, Roberts, Rockwall, Runnels, Rusk, Sabine, San Augustine, Schleicher, Scurry, Shackelford, Shelby, Sherman, Smith, Stephens, Sterling, Stonewall, Sutton, Swisher, Tarrant, Taylor, Terry, Throckmorton, Titus, Tom Green, Upshur, Upton, Van Zandt, Ward, Wheeler, Wichita, Wilbarger, Winkler, Wise, Wood, Yoakum, and Young.

Collector: George C. Hopkins, Dallas.

Div. Hdqrs. at: Wichita Falls, Fort Worth, Abilene, Tyler.

### UTAH (Comprising the State of Utah),

Collector: James H. Anderson, Salt Lake City.

Stamp Office at: Ogden.

### VERMONT (Comprising the State of Vermont),

Collector: Robert W. McCuen, Burlington.

### VIRGINIA (Comprising the State of Virginia),

Collector: John C. Noel, Richmond.

Div. Hdqrs. at: Norfolk,\* Lynchburg,\* Roanoke,\* Alexandria.\*

Stamp Offices at: Petersburg, Martinsville, Danville.

### WASHINGTON (Comprising the State of Washington and the Territory of Alaska),

Collector: Burns Poe, Tacoma.

Div. Hdqrs. at: Seattle,\* Spokane.

### WEST VIRGINIA (Comprising the State of West Virginia),

Collector: Albert B. White, Parkersburg.

Div. Hdqrs. at: Wheeling,\* Charleston, Huntington,\* Clarksburg.

Stamp Offices at: Fairmont.

### WISCONSIN (Comprising the State of Wisconsin),

Collector: Alonzo H. Wilkinson, Milwaukee.

Div. Hdqrs. at: Madison,\* Green Bay, Oshkosh, Superior, La Crosse, Racine.

### WYOMING (Comprising the State of Wyoming),

Collector: Marshall S. Reynolds, Cheyenne.

\*Stamps sold.









was made, however, in the amended returns for the good-will item aforementioned. Upon the request of the Unit for advice on the subjects involving the good-will item, 20.19x dollars was disallowed as a capital item. The money in bank, 34.33x dollars, was also excluded from invested capital on the ground that it was not the property of the corporation.

It appears that the savings bank of the city of S as a matter of policy refused to receive partnership funds for deposit, and because of such refusal the partners deposited a part of the surplus each year in the names of the partners, A and B. After incorporation these individuals owned over 95 per cent of the stock of the appellant company, and from February 1, 1914, to the date of liquidation of the appellant company in 1920 the amounts in the savings banks credited to the above-named individuals were continuously increased. The accounts of the corporation, however, contain no record of these deposits or interest accrued thereon.

There is of record evidence showing that A and B wrote letters to mercantile houses stating that the amounts in the R Bank credited to their accounts were the property of the appellant company; that such statements were given to mercantile agencies; that on May —, 1918, the appellant company borrowed from the R Bank the sum of 10x dollars, and later, on November —, 1918, the sum of 10x dollars, on the credit established by the savings deposits credited to A and B; that in 1920, when the business was liquidated, the cost of liquidation was paid out of these deposits, and the balance distributed among the stockholders.

The Committee is unable to agree with the appellant's contention that the deposits in savings banks in the names of A and B constituted assets of the corporation. As a matter of law, the corporation had no title to these deposits, and the fact that it may have received credit upon the basis of such deposits is immaterial. There is no basis in the law or regulations for the inclusion of these deposits in the statutory invested capital of the corporation.

The Committee therefore recommends that the action of the Income Tax Unit be sustained and the appeal denied.

\* \* \* \* \*

KINGMAN BREWSTER,  
*Chairman Committee on Appeals and Review.*

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II ('23)-34-1209: I. T. 1848

### Revenue Acts of 1917, 1918, and 1921.

A corporation organized in 1917 used only borrowed money in acquiring its assets. It was not entitled to any statutory invested capital at the date of its organization.

For the purpose of computing depreciation the property should be valued at its cost price, in spite of the fact that it was purchased with borrowed money. In ascertaining the amount upon which depreciation is to be computed the purchase price should be allocated between depreciable and nondepreciable assets.

In 1917 a corporation, organized that year, acquired a mill from another corporation. The purchaser obtained a portion of the money necessary for the purpose by borrowing on the security of a deed of trust; it obtained another portion by borrowing from a third corporation, and gave its notes to the vendor corporation for the balance of the agreed price. The purchaser then issued capital stock to its own incorporators in an amount greatly in excess of the purchase price of the property. This stock was watered stock, as the corporation received no assets in exchange for the same. The property was appraised during 1918 at an amount in excess of the purchase price but

Supplementary Bulletin Rulings.

below the amount of the capital stock issued. The corporation thereupon balanced the amount of its liabilities, represented by its capital stock and notes payable, by assets representing the plant at its appraised value and an item designated as intangible property representing the excess of its liabilities over the appraised value of its plant.

Held, as the purchaser used only borrowed money in acquiring its assets it was not entitled to any statutory invested capital at the date of its organization. This fact, however, did not bring it within section 209 of the Revenue Act of 1917, as it employed a substantial amount of borrowed capital in conducting its business. The appraisal of its assets in 1918 at a figure in excess of the amount paid for them did not entitle the taxpayer to any paid-in surplus or to any addition to invested capital.

For the purpose of computing depreciation the property should be valued at its cost price, in spite of the fact that it was purchased with borrowed money. In ascertaining the amount upon which depreciation is to be computed the purchase price should be allocated between depreciable and non-depreciable assets.

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**Supplementary Rulings Reprinted from the Internal Revenue Bulletins.**

**The Foreword to the Supplementary Rulings should be read.**

**Caution.**—To the extent of the imposition of the excess-profits tax for 1921, the 1918 and 1921 laws are identical, except that domestic corporations entitled to the benefits of Section 262 of the 1921 Act (§1083) are grouped with foreign corporations for the purposes of the 1921 excess-profits tax. To much the same extent, with like qualifications, the provisions of Regulations 62 (1921 Act) are essentially identical (there are frequent verbal changes) to the provisions of Regulations 45 (1918 Act). The numbering of the Articles of Regulations 62 (1921 Act) is the same as that of the respective corresponding Articles of Regulations 45 (1918 Act), except as noted below. It follows then, that, except as noted below, for the purposes of the Supplementary Bulletin Rulings, the Article reference number is the same under either Act.

Reg. 62 (1921 Act)	Reg. 45 (1918 Act)
No corresponding Article.....	to Article 712
Article 712 is the same as, therefore refer to, Article	713
“ 713 “ “ “ “ “ “ “ “ “	714
“ 714 “ “ “ “ “ “ “ “ “	715
“ 715 “ “ “ “ “ “ “ “ “	716
No corresponding Article.....	to Article 717
Article 716 is the same as, therefore refer to, Article	719
“ 717 “ “ “ “ “ “ “ “ “	718
“ 718 “ “ “ “ “ “ “ “ “	720
No corresponding Article.....	to Article 869
Article 869 is the same as, therefore refer to, Article	870
870 “ “ “ “ “ “ “ “ “	871

Art. of Reg. 62 is same as, therefore refer to, same numbered Art. of Reg. 45  
(The list is always up-to-date.)

Law Section	Article Number	Last Ruling	Law Section	Article Number	Last Ruling
300.....	701.....	None	302.....	732.....	1
301.....	711.....	1	".....	733.....	None
".....	712.....	None	303.....	741.....	2
".....	713.....	None	".....	742.....	None
".....	714.....	11	".....	743.....	None
".....	715.....	2	304.....	751.....	None
".....	716.....	None	".....	752.....	1
".....	717.....	None	".....	753.....	None
".....	718.....	None	305.....	761.....	None
".....	719.....	1	310.....	771.....	1
".....	720.....	None	311.....	781.....	3
302.....	731.....	1	".....	782.....	None

(Over.)

Law Section	Article Number	Last Ruling	Law Section	Article Number	Last Ruling
311.....	783.....	1	326.....	854.....	2
".....	784.....	None	".....	855.....	1
".....	785.....	None	".....	856.....	None
312.....	791.....	4	".....	857.....	7
320.....	801.....	1	".....	858.....	10
".....	802.....	1	".....	859.....	2
325.....	811.....	2	".....	860.....	1
".....	812.....	3	".....	861.....	None
".....	813.....	10	".....	862.....	4
".....	814.....	None	".....	863.....	None
".....	815.....	9	".....	864.....	None
".....	816.....	1	".....	865.....	None
".....	817.....	1	".....	866.....	None
".....	818.....	3	".....	867.....	None
326.....	831.....	44	".....	868.....	None
".....	832.....	None	".....	869.....	1
".....	833.....	6	".....	870.....	1
".....	834.....	1	".....	871.....	1
".....	835.....	4	327.....	901.....	31
".....	836.....	19	328.....	911.....	2
".....	837.....	7	".....	912.....	3
".....	838.....	10	".....	913.....	1
".....	839.....	4	".....	914.....	2
".....	840.....	10	330.....	931.....	4
".....	841.....	5	".....	932.....	1
".....	842.....	None	".....	933.....	8
".....	843.....	2	".....	934.....	None
".....	844.....	2	331.....	941.....	19
".....	845.....	11	335.....	951.....	None
".....	845A.....	(See 845)	".....	952.....	1
".....	846.....	4	".....	953.....	None
".....	847.....	None	".....	954.....	None
".....	848.....	None	".....	955.....	None
".....	849.....	None	336.....	961.....	None
".....	850.....	2	".....	962.....	None
".....	851.....	7	337.....	971.....	2
".....	852.....	2	".....	972.....	None
".....	853.....	1	338.....	981.....	None

Every Article of Regulations 45 (1918 Act) and of Regulations 62 (1921 Act) bearing specifically on the war-profits and excess-profits tax is listed in the foregoing table. The first Article is 701.

Missing Article numbers such as 702 to 710 have not yet been used.

*The last Bulletin from which rulings have been reproduced hereinbefore and as listed above is*

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*Later Bulletins, since issued (if any), contain no rulings bearing on the 1918 or 1921 excess-profits tax laws.*

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**The Foreword to the Supplementary Rulings should be read.**

The numeral, in each case, shows *how many* serially numbered special rulings bearing on the particular Article have been reproduced and indicates *the last* serial number of the group. These serial numbers appear in bold face type at the *end* of the special rulings themselves, within the Supplement.

Reg. 62 (1921 Act)

Reg. 45 (1918 Act)

Article 712 is the same as, therefore refer to, Article 713

“ 713 “ “ “ “ “ “ “ “ 714

“ 714 “ “ “ “ “ “ “ 715

“ 715 “ “ “ “ “ “ “ 716

No corresponding Article.....to Article 717

Article 716 is the same as, therefore refer to, Article 719

“ 717 “ “ “ “ “ “ “ 718

“ 718 “ “ “ “ “ “ “ 720

No corresponding Article.....to Article 869

Article 869 is the same as, therefore refer to, Article 870

“ 870 “ “ “ “ “ “ “ “ 871

Art. of Reg. 62 is same as, therefore refer to, same numbered Art. of Reg. 45

Law Section	Article Number	Last Ruling
300.....	701	None
301.....	711.....	1
"	712.....	None
"	713.....	None
"	714.....	11
"	715.....	2
"	716.....	None
"	717.....	None
"	718.....	None
"	719.....	1
"	720.....	None
302.....	731.....	1

Law Section	Article Number	Last Ruling
302.....	732.....	1
".....	733.....	None
303.....	741.....	2
".....	742.....	None
".....	743.....	None
304.....	751.....	None
".....	752.....	1
".....	753.....	None
305.....	761.....	None
310.....	771.....	1
311.....	781.....	3
".....	782.....	None

(Over.)

Law Section	Article Number	Last Ruling	Law Section	Article Number	Last Ruling
311.....	783.....	1	326.....	854.....	2
".....	784.....	None	".....	855.....	1
".....	785.....	None	".....	856.....	None
312.....	791.....	4	".....	857.....	7
320.....	801.....	1	".....	858.....	10
".....	802.....	1	".....	859.....	2
325.....	811.....	2	".....	860.....	1
".....	812.....	3	".....	861.....	None
".....	813.....	10	".....	862.....	4
".....	814.....	None	".....	863.....	None
".....	815.....	9	".....	864.....	None
".....	816.....	1	".....	865.....	None
".....	817.....	1	".....	866.....	None
".....	818.....	3	".....	867.....	None
326.....	831.....	44	".....	868.....	None
".....	832.....	None	".....	869.....	1
".....	833.....	5	".....	870.....	1
".....	834.....	1	".....	871.....	1
".....	835.....	4	327.....	901.....	31
".....	836.....	19	328.....	911.....	2
".....	837.....	7	".....	912.....	3
".....	838.....	10	".....	913.....	1
".....	839.....	4	".....	914.....	2
".....	840.....	10	330.....	931.....	4
".....	841.....	5	".....	932.....	1
".....	842.....	None	".....	933.....	8
".....	843.....	2	".....	934.....	None
".....	844.....	2	331.....	941.....	19
".....	845.....	11	335.....	951.....	None
".....	845A.....	(See 845)	".....	952.....	1
".....	846.....	4	".....	953.....	None
".....	847.....	None	".....	954.....	None
".....	848.....	None	".....	955.....	None
".....	849.....	None	336.....	961.....	None
".....	850.....	2	".....	962.....	None
".....	851.....	7	337.....	971.....	2
".....	852.....	2	".....	972.....	None
".....	853.....	1	338.....	981.....	None

Every Article of Regulations 45 (1918 Act) and of Regulations 62 (1921 Act) bearing specifically on the war-profits and excess-profits tax is listed in the foregoing table. The first Article is 701.

Missing Article numbers such as 702 to 710 have not yet been used.

*The last Bulletin from which rulings have been reproduced hereinbefore and as listed above is*

**VOLUME II (1923), No. 35.**

*Later Bulletins, since issued (if any), contain no rulings bearing on the 1918 or 1921 excess-profits tax laws.*

**Insert this page to face blue page 401.**





Law Section	Article Number	Last Ruling
311	783	1
"	784	None
"	785	None
312	791	4
320	801	1
"	802	1
325	811	2
"	812	3
"	813	10
"	814	None
"	815	9
"	816	1
"	817	1
"	818	3
326	831	44
"	832	None
"	833	5
"	834	1
"	835	4
"	836	19
"	837	7
"	838	10
"	839	4
"	840	10
"	841	5
"	842	None
"	843	2
"	844	2
"	845	11
"	845A	(See 845)
"	846	4
"	847	None
"	848	None
"	849	None
"	850	2
"	851	7
"	852	2
"	853	1

Law Section	Article Number	Last Ruling
326	854	2
"	855	1
"	856	None
"	857	7
"	858	10
"	859	2
"	860	1
"	861	None
"	862	4
"	863	None
"	864	None
"	865	None
"	866	None
"	867	None
"	868	None
"	869	1
"	870	1
"	871	1
327	901	30
328	911	2
"	912	3
"	913	1
"	914	2
330	931	4
"	932	1
"	933	7
"	934	None
331	941	18
335	951	None
"	952	1
"	953	None
"	954	None
"	955	None
336	961	None
"	962	None
337	971	2
"	972	None
338	981	None

Every Article of Regulations 45 (1918 Act) and of Regulations 62 (1921 Act) bearing specifically on the war-profits and excess-profits tax is listed in the foregoing table. The first Article is 701.

**Missing Article numbers** such as 702 to 710 have not yet been used.

*The last Bulletin from which rulings have been reproduced hereinbefore and as listed above is*

**VOLUME II (1923), No. 34.**

*Later Bulletins, since issued (if any), contain no rulings bearing on the 1918 or 1921 excess-profits tax laws.*

**Insert this page to face blue page 401.**



I(22)-29-417: A. R. R. 988

**Act of October 3, 1917, Section 208. Act of February 24, 1919, Section 331.**

Recommended, in the appeal of the M Company, that the action of the Income Tax Unit in requiring the appellant to file amended returns for the taxable years affected pursuant to Treasury Decision 3220 (C. B. 5, p. 285), be sustained.

The Committee has carefully considered the oral appeal of the M Company from the action of the Income Tax Unit in requiring it to file amended returns for the taxable years affected, pursuant to the provisions of Treasury Decision 3220. [¶865 herein]

The M Company was organized under the laws of the State of Y in 1897 and its charter expired in accordance with its terms in September, 1917. The corporation commissioner of the State of Y having held that under section 6705 of the State of Y Laws the existence of a corporation could not be continued by the filing of supplemental articles of incorporation, the M Company was organized September, 1917, with an authorized capital stock of 30x dollars, which was the same as that of the original company. The stock of the new company was issued to the stockholders of the original company share for share, and all the assets of the old corporation were thereupon transferred to the new corporation at their market value as of September, 1917, and such value was utilized in the preparation of the tax returns of the company. Under date of February —, 1922, demand was made upon the company that it file amended returns for the taxable years affected by the use of such increased invested capital in accordance with the provisions of Treasury Decision 3220 (C. B. 5, p. 285).

Owing to the peculiar circumstances existing in this case the appellant was allowed to file an oral appeal, and argument by its representatives was heard by the Committee on April —, 1922. It is contended by the appellant that the purpose and intent of section 208 of the Act of October 3, 1917, and section 331 of the Act of February 24, 1919, were to prohibit the inflation of the invested capital of a corporation through a voluntary reorganization, and that these sections should not apply to a case like the present, in which the reorganization or change of ownership was wholly involuntary and due solely to the expiration of the charter of the original corporation. It was admitted by the representatives of the appellant at the oral hearing that the assets of the original corporation were never actually distributed to the stockholders but were transferred directly by deed of the original corporation to the new corporation.

Section 208 of the Act of October 3, 1917, provides:

That in the case of the reorganization, consolidation, or change of ownership of a trade or business after March 3, 1917, if an interest or control in such trade or business of 50 per centum or more remains in control of the same persons, corporations, associations, partnerships, or any of them, then in ascertaining the invested capital of the trade or business no asset transferred or received from the prior trade or business shall be allowed a greater value than would have been allowed under this title in computing the invested capital of such prior trade or business if such asset had not been so transferred or received, unless such asset was paid for specifically as such, in cash or tangible property, and then not to exceed the actual cash or actual cash value of the tangible property paid therefor at the time of such payment.

The same provision, with certain modifications which are not here material, was enacted as section 331 of the Act of February 24, 1919.

Section 6699 of the State of Y Laws provides that:

All corporations that expire by limitation specified in their articles of incorporation, \* \* \* continue to exist as bodies corporate for a period of five years thereafter, if necessary for the purpose of prosecuting or defending actions, suits, or proceedings by or against them, settling their business, disposing of their property, and dividing their capital stock, but not for the purpose of continuing their corporate business.

An examination of section 6705 of the State of Y Laws leads the Committee to concur in the opinion of the corporation commissioner of the State of Y that the existence of the original corporation could not have been continued by the filing of supplemental articles of incorporation, and that, therefore, the M Company constituted a new and separate corporation, but under the provisions of section 6699 the assets of the original corporation did not upon the expiration of its charter automatically revert to the stockholders, but the corporation continued for the purpose of winding up its affairs, and in accordance with the powers thus continued to it, its assets were conveyed to the new corporation.

Without attempting to characterize the proceedings in this case, it is clear that there was a "change of ownership of a trade or business" or "a change of ownership of property," occurring after March 3, 1917, and not only 50 per centum but 100 per centum of the interest or control remained in the same persons. This case, therefore, clearly falls within the language of both sections 208 of the Act of October 3, 1917, and section 331 of the Act of February 24, 1919, and it does not appear to the Committee that it is outside the purpose and intent of those sections. The sections of the statutes themselves contain no exception in the case of an involuntary change of ownership and it seems clear the intent of Congress was to prevent the increase of the invested capital of a corporation by including therein appreciation in the value of its assets upon a change of ownership which was nominal and not substantial.

The Committee, therefore, finds that the appeal in this case is without merit and accordingly recommends that the action of the Income Tax Unit in requiring the M Company to file amended returns for the taxable years affected, pursuant to Treasury Decision 3220, be sustained.



none of these six corporations is in exactly the same position as the taxpayer. The invested capital of comparatives 1 and 2 is approximately four times as large as the invested capital of the taxpayer; their gross income is nearly twice as large; their expense accounts do not compare favorably with that of the taxpayer. The amount of gross sales of comparative 6 is less than one-half that of the taxpayer. Its cost of goods sold is less than one-third that of the taxpayer, as is its expense account; its net income is considerably less than that of the taxpayer, while the proportion of its net income to gross sales is approximately twice that of the taxpayer. Furthermore, comparatives 3, 4, and 5, as may be seen, are circumstanced in many respects quite differently from the taxpayer. Thus, none of the six comparatives which are most nearly similarly circumstanced with the taxpayer is ideal. Nevertheless, the taxpayer is entitled to relief under section 328, and corporations must be used as comparatives which are similarly circumstanced as nearly as may be with the taxpayer. The six corporations used as comparatives in this case are those, I am advised, most similarly circumstanced with the taxpayer with respect to the items specified in section 328. Furthermore, the items of some which are dissimilar to the taxpayer are balanced by the corresponding items of the other comparatives, and the correctness of the result reached by the use of these comparatives is shown by the fact that the average obtained by grouping the six comparatives compares very closely with the taxpayer.

In the instant case the comparatives used are the ones most comparable to the taxpayer with respect to the items specified in section 328 and the average of these comparatives compares in every respect favorably with the taxpayer. It is my opinion, therefore, that the comparatives used in the data sheet prepared in this case comply with the provisions of section 328.

Law Opinion 1090 [Sec. 327. Art. 901.-31, herein.] is hereby revoked.

CARL A. MAPES,  
*Solicitor of Internal Revenue.*





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**Key.**—The word “none,” in the column headed “Last Ruling,” signifies in each case that there are no special rulings bearing on the particular Article of Regulations 45 (1918 Act) or of Regulations 62 (1921 Act).

The numeral, in each case, shows *how many* serially numbered special rulings bearing on the particular Article have been reproduced and indicates *the last* serial number of the group. These serial numbers appear in bold face type at the *end* of the special rulings themselves, within the Supplement.

**Caution.**—To the extent of the imposition of the excess-profits tax for 1921, the 1918 and 1921 laws are identical, except that domestic corporations entitled to the benefits of Section 262 of the 1921 Act (§1083) are grouped with foreign corporations for the purposes of the 1921 excess-profits tax. To much the same extent, with like qualifications, the provisions of Regulations 62 (1921 Act) are essentially identical (there are frequent verbal changes) to the provisions of Regulations 45 (1918 Act). The numbering of the Articles of Regulations 62 (1921 Act) is the same as that of the respective corresponding Articles of Regulations 45 (1918 Act), except as noted below. It follows then, that, except as noted below, for the purposes of the Supplementary Bulletin Rulings, the Article reference number is the same under either Act.

Reg. 62 (1921 Act)	Reg. 45 (1918 Act)
No corresponding Article.....	to Article 712
Article 712 is the same as, therefore refer to, Article	713
" 713 " " " " " " " " "	714
" 714 " " " " " " " " "	715
" 715 " " " " " " " " "	716
No corresponding Article.....	to Article 717
Article 716 is the same as, therefore refer to, Article	719
" 717 " " " " " " " " "	718
" 718 " " " " " " " " "	720
No corresponding Article.....	to Article 869
Article 869 is the same as, therefore refer to, Article	870
870 " " " " " " " " "	871

Otherwise

Art. of Reg. 62 is same as, therefore refer to, same numbered Art. of Reg. 45

(The list is always up-to-date.)

Law Section	Article Number	Last Ruling	Law Section	Article Number	Last Ruling
300.....	701.....	None	302.....	732.....	1
301.....	711.....	1	".....	733.....	None
".....	712.....	None	303.....	741.....	2
".....	713.....	None	".....	742.....	None
".....	714.....	11	".....	743.....	None
".....	715.....	2	304.....	751.....	None
".....	716.....	None	".....	752.....	1
".....	717.....	None	".....	753.....	None
".....	718.....	None	305.....	761.....	None
".....	719.....	1	310.....	771.....	1
".....	720.....	None	311.....	781.....	3
302.....	731.....	1	".....	782.....	None

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(Over.)

Law Section	Article Number	Last Ruling	Law Section	Article Number	Last Ruling
311.....	783.....	1	326.....	854.....	2
".....	784.....	None	".....	855.....	1
".....	785.....	None	".....	856.....	None
312.....	791.....	4	".....	857.....	7
320.....	801.....	1	".....	858.....	10
".....	802.....	1	".....	859.....	2
325.....	811.....	2	".....	860.....	1
".....	812.....	3	".....	861.....	None
".....	813.....	10	".....	862.....	4
".....	814.....	None	".....	863.....	None
".....	815.....	9	".....	864.....	None
".....	816.....	1	".....	865.....	None
".....	817.....	1	".....	866.....	None
".....	818.....	3	".....	867.....	None
326.....	831.....	43	".....	868.....	None
".....	832.....	None	".....	869.....	1
".....	833.....	5	".....	870.....	1
".....	834.....	1	".....	871.....	1
".....	835.....	4	327.....	901.....	30
".....	836.....	19	328.....	911.....	2
".....	837.....	7	".....	912.....	3
".....	838.....	10	".....	913.....	1
".....	839.....	4	".....	914.....	2
".....	840.....	10	330.....	931.....	4
".....	841.....	5	".....	932.....	1
".....	842.....	None	".....	933.....	7
".....	843.....	2	".....	934.....	None
".....	844.....	2	331.....	941.....	18
".....	845.....	11	335.....	951.....	None
".....	845A.....	(See 845)	".....	952.....	1
".....	846.....	4	".....	953.....	None
".....	847.....	None	".....	954.....	None
".....	848.....	None	".....	955.....	None
".....	849.....	None	336.....	961.....	None
".....	850.....	2	".....	962.....	None
".....	851.....	7	337.....	971.....	2
".....	852.....	2	".....	972.....	None
".....	853.....	1	338.....	981.....	None

Every Article of Regulations 45 (1918 Act) and of Regulations 62 (1921 Act) bearing specifically on the war-profits and excess-profits tax is listed in the foregoing table. The first Article is 701.

**Missing Article numbers** such as 702 to 710 have not yet been used.

*The last Bulletin from which rulings have been reproduced hereinbefore and as listed above is*

**VOLUME II (1923), No. 33.**

*Later Bulletins, since issued (if any), contain no rulings bearing on the 1918 or 1921 excess-profits tax laws.*

**Insert this page to face blue page 401.**



was made, however, in the amended returns for the good-will item aforementioned. Upon the request of the Unit for advice on the subjects involving the good-will item, 20.19x dollars was disallowed as a capital item. The money in bank, 34.33x dollars, was also excluded from invested capital on the ground that it was not the property of the corporation.

It appears that the savings bank of the city of S as a matter of policy refused to receive partnership funds for deposit, and because of such refusal the partners deposited a part of the surplus each year in the names of the partners, A and B. After incorporation these individuals owned over 95 per cent of the stock of the appellant company, and from February 1, 1914, to the date of liquidation of the appellant company in 1920 the amounts in the savings banks credited to the above-named individuals were continuously increased. The accounts of the corporation, however, contain no record of these deposits or interest accrued thereon.

There is of record evidence showing that A and B wrote letters to mercantile houses stating that the amounts in the R Bank credited to their accounts were the property of the appellant company; that such statements were given to mercantile agencies; that, on May —, 1918, the appellant company borrowed from the R Bank the sum of 10x dollars, and later, on November —, 1918, the sum of 10x dollars, on the credit established by the savings deposits credited to A and B; that in 1920, when the business was liquidated, the cost of liquidation was paid out of these deposits, and the balance distributed among the stockholders.

The Committee is unable to agree with the appellant's contention that the deposits in savings banks in the names of A and B constituted assets of the corporation. As a matter of law, the corporation had no title to these deposits, and the fact that it may have received credit upon the basis of such deposits is immaterial. There is no basis in the law or regulations for the inclusion of these deposits in the statutory invested capital of the corporation.

The Committee therefore recommends that the action of the Income Tax Unit be sustained and the appeal denied.

\* \* \* \* \*

KINGMAN BREWSTER,

*Chairman Committee on Appeals and Review.*





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The references are to paragraph numbers.

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Reversed, July 5, 1923, 3d C. C. of A (289 Fed. 1010).....	(Stamp Taxes)	4050
In U. S. Supreme Court on writ of certiorari.....	(Stamp Taxes)	4080
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Gaston: Nichols vs. (281 Fed. 67).....	(Estate Tax)	317
George: Bailey vs. (Child Labor Tax) Dec. 1922 Cum. Bull. p. 342.		
Greenport Basin and Construction Co. vs. U. S. (U. S. Supreme Court, Jan. 2, 1923) (T. D. 3429).....	(Excess Profits Tax)	1297
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Howard vs. Malley (281 Fed. 363).....	(Capital Stock Tax)	3108
Iredell: DeLaski & Thropp Circular Woven Tire Co. vs. (268 Fed. 377).....	(Excess Profits Tax)	913
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Lederer: Fidelity Trust Co. vs. (276 Fed. 51).....	(Stamp Taxes)	4010
Reversed, July 5, 1923, 3d C. C. of A (289 Fed. 1010).....	(Stamp Taxes)	4050
In U. S. Supreme Court on writ of certiorari.....	(Stamp Taxes)	4080
Lederer: Pennsylvania Company for Insurance on Lives and Granting Annuities, et al., Executors (Colfelt) (T. D. 3524).....	(Estate Tax)	E538
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Mills Woven Cartridge Belt Co. vs. Malley (Munitions Taxes) .. Bull. II ('23)-3, p. 30.	
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Decision	Aug. 1, 1923	West Virginia Pulp & Paper Company vs. Bowers.—Issue of four \$25 shares in exchange for each outstanding \$100 share.....	4062
Decision	July 24, 1923	American Laundry Machinery Company vs. Dean, Collector; and Procter and Gamble Company vs. Dean, Collector.—Issue of a number of shares of smaller par value in exchange for each outstanding share and aggregating the par value thereof, held to be not subject to tax.....	4063
Decision	Sept. 22, 1923	Trumbull Steel Co. vs. Routzahn, Collector.—Issue of four \$25 shares in exchange for each outstanding \$100 share is not subject to tax as original issue on reorganization.....	4072
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3536	Oct. 23, 1923	Art. 17, Reg. 40, amended.—Returns by persons engaged in the business of buying, selling or transferring shares of stock.....	4081

Insert this sheet immediately before the blue Stamp Tax index.



## STAMP TAX REGULATIONS.

of a corporate reorganization. Obviously, that part of this definition which might be taken as classifying as a reorganization a mere adjustment of stock among stockholders, is excluded by *Edwards v. Wabash Ry. Co.*, and the reenactment by Congress of the same provisions without change of language after this construction was declared.

*Defendant's demurrer is overruled. An exception is noted.*

**4080 Lederer vs. Fidelity Trust Company.**—[The United States Supreme Court, on October 22, 1923, granted the petition for a writ of certiorari in this case (§4050). (Docket No. 582, October Term, 1923.)—The Corporation Trust Company.]

(T. D. 3526.)

*(Changed completely, in effect.)*

**4081 Returns by persons engaged in the business of buying, selling or**  
3636 **transferring shares of stock. Article 17 of Regulations No. 40 (1922 Edition) amended.**—Article 17 of Regulations No. 40 (1922 Edition) [§3636] is hereby amended to read as follows:

**4082 "Art. 17. Returns by persons making sales.**—(a) All persons who are wholly or partly engaged in the business of buying, selling or transferring shares of stock, whether such sales, purchases or transfers shall be made, cleared, settled, or adjusted through a clearing house, or otherwise, shall on or before the fifteenth day of each month, and at any other time designated by the Commissioner, render under oath a true return (Form 838, Revised 1923) for the preceding month or for any other period designated by the Commissioner. This return should be made to the collector of internal revenue for the district in which such person or persons are located, and should contain in detail the following data and information:

- (1) The month for which the return is made.
- (2) The name and address of the person, partnership, corporation, or association making the return.
- (3) The value of stamps on hand on the first day of the month.
- (4) The value of stamps purchased during the month.
- (5) The value of stamps used during the month.
- (6) Balance of stamps on hand at end of month.

**4083** (b) This return is required to be filed for each month even though no transactions occurred during the month." (T. D. 3526, signed by Commissioner D. H. Blair, and dated October 23, 1923.)





## STAMP TAX REGULATIONS.

3546

## REGULATIONS 40—1922 EDITION

[Promulgated July 8, 1922—Also designated as T. D. 3380.]

(Supplemented.)

Relating to the

STAMP TAX ON ISSUES, SALES, AND TRANSFERS OF STOCK AND SALES OF  
PRODUCTS FOR FUTURE DELIVERY

Under

SUBDIVISIONS 2, 3, AND 4 OF SCHEDULE A, TITLE XI, OF THE REVENUE ACT  
OF 1921.

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3. Computation of the tax.....	3550
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5. Issues not subject to tax.....	3576; A, 4040
6. Stamp tax acts.....	3585
7. Documentary stamps used.....	3588
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USAGES OF EXCHANGES FOR FUTURE DELIVERY.

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**PART I.****ISSUES OF STOCK.**

**3547** Art. 1. When tax accrues.—Stock is deemed to be issued when  
 3521 it is subscribed for and the subscription is accepted by the corporation, regardless of the time of delivery of the certificate.

**3548** Art. 2. Rate of taxation.—(a) All certificates or instruments, of whatever designation, having a par or face value, representing shares of stock, or of profits, or of interest in property or accumulations, issued by any corporation, joint-stock company or association, are subject to tax at the rate of 5 cents on each \$100 of the face value or fraction thereof.

**3549** (b) All certificates of stock, or of profits, or of interest in property or accumulations issued by any corporation, without par or face value, are subject to the tax of 5 cents per share, unless the actual value is in excess of \$100 per share, in which case the tax shall be 5 cents on each \$100 of actual value or fraction thereof, or unless the actual value is less than \$100 per share, in which case the tax shall be 1 cent on each \$20 of actual value or fraction thereof. [See ¶4016 and ¶4019].



## CAPITAL STOCK TAX.—RUNNING TABLE OF CONTENTS.

## Rulings, Regulations, Opinions and Decisions

under the

## Capital Stock Tax Law Provisions.

Giving Treasury Decision Number or other Designation, General Subject Content,  
Date of Issue, and Paragraph Reference.

T. D.	Date	Subject	Paragraph
Law Provisions.....			3000
Reg. 64	June 15, 1922	Comprehensive regulations relating to the Capital Stock tax.....	Page 609
Decision	Feb. 14, 1921	Washington Water Power Co. vs. U. S. Court of Claims decision, 1916 Act. Validity of Tax; payment in advance.....	3105
Decision	June 6, 1922	Malley vs. Howard et al., Trustees. C. C. of A., First Circuit. Certain trusts of the Massachusetts type are liable to tax.....	3108
Decision	May 25, "	Central Union Trust Co. vs. Edwards, U. S. D. C., Southern District of New York. As the measure of the tax the fair average value of the capital stock of a corporation is the equivalent of the fair average value of the enterprise in its entirety as a going concern.....	3162

## The matters listed above are indexed.

The regulations, rulings, etc., listed below are those issued during 1923.

Decision	Jan. 8, 1923	Central Union Trust Co. vs. Edwards, C. C. of A., Second Circuit. Affirming decision of May 25, 1922 above	3171
3438	Feb. 10, "	T. D. designation for the Central Union Trust Company vs. Edwards decision, listed under Jan. 8, 1923 above.	
Decision	June 1, "	National Paper and Type Co. vs. Edwards.—To tax a domestic corporation whose capital is employed in whole or in part in the export trade is not unconstitutional as imposing a tax on exports.....	3199





**Perpetual Check List**  
Supplementary Rulings Reprinted from the Internal Revenue Bulletins.

The Supplementary Rulings are printed on the pages immediately preceding.

The Foreword to the Supplementary Rulings should be read.

**Key.**—The word “none,” in the column headed “Last Ruling,” signifies in each case that there are no special rulings bearing on the particular Article of Regulations 45 (1918 Act) or of Regulations 62 (1921 Act).

The numeral, in each case, shows *how many* serially numbered special rulings bearing on the particular Article have been reproduced and indicates *the last* serial number of the group. These serial numbers appear in bold face type at the *end* of the special rulings themselves, within the Supplement.

**Caution.**—To the extent of the imposition of the excess-profits tax for 1921, the 1918 and 1921 laws are identical, except that domestic corporations entitled to the benefits of Section 262 of the 1921 Act (§1083) are grouped with foreign corporations for the purposes of the 1921 excess-profits tax. To much the same extent, with like qualifications, the provisions of Regulations 62 (1921 Act) are essentially identical (there are frequent verbal changes) to the provisions of Regulations 45 (1918 Act). The numbering of the Articles of Regulations 62 (1921 Act) is the same as that of the respective corresponding Articles of Regulations 45 (1918 Act), except as noted below. It follows then, that, except as noted below, for the purposes of the Supplementary Bulletin Rulings, the Article reference number is the same under either Act.

Reg. 62 (1921 Act)	Reg. 45 (1918 Act)
No corresponding Article.....	to Article 712
Article 712 is the same as, therefore refer to, Article	713
“ 713 “ “ “ “ “ “ “ “ “	714
“ 714 “ “ “ “ “ “ “ “ “	715
“ 715 “ “ “ “ “ “ “ “ “	716
No corresponding Article.....	to Article 717
Article 716 is the same as, therefore refer to, Article	719
“ 717 “ “ “ “ “ “ “ “ “	718
“ 718 “ “ “ “ “ “ “ “ “	720
No corresponding Article.....	to Article 869
Article 869 is the same as, therefore refer to, Article	870
870 “ “ “ “ “ “ “ “ “	871

### Otherwise

Art. of Reg. 62 is same as, therefore refer to, same numbered Art. of Reg. 45  
(The list is always up-to-date.)

Law Section	Article Number	Last Ruling	Law Section	Article Number	Last Ruling
300.....	701.....	None	302.....	732.....	1
301.....	711.....	1	".....	733.....	None
".....	712.....	None	303.....	741.....	2
".....	713.....	None	".....	742.....	None
".....	714.....	11	".....	743.....	None
".....	715.....	2	304.....	751.....	None
".....	716.....	None	".....	752.....	1
".....	717.....	None	".....	753.....	None
".....	718.....	None	305.....	761.....	None
".....	719.....	1	310.....	771.....	1
".....	720.....	None	311.....	781.....	3
302.....	731.....	1	".....	782.....	None

Insert immediately preceding blue page 401.

(Over.)

Law Section	Article Number	Last Ruling	Law Section	Article Number	Last Ruling
311.....	783.....	1	326.....	854.....	2
".....	784.....	None	".....	855.....	1
".....	785.....	None	".....	856.....	None
312.....	791.....	4	".....	857.....	7
320.....	801.....	1	".....	858.....	10
".....	802.....	1	".....	859.....	2
325.....	811.....	2	".....	860.....	1
".....	812.....	3	".....	861.....	None
".....	813.....	10	".....	862.....	4
".....	814.....	None	".....	863.....	None
".....	815.....	9	".....	864.....	None
".....	816.....	1	".....	865.....	None
".....	817.....	1	".....	866.....	None
".....	818.....	3	".....	867.....	None
326.....	831.....	43	".....	868.....	None
".....	832.....	None	".....	869.....	1
".....	833.....	5	".....	870.....	1
".....	834.....	1	".....	871.....	1
".....	835.....	4	327.....	901.....	30
".....	836.....	18	328.....	911.....	2
".....	837.....	7	".....	912.....	3
".....	838.....	10	".....	913.....	1
".....	839.....	4	".....	914.....	2
".....	840.....	10	330.....	931.....	4
".....	841.....	5	".....	932.....	1
".....	842.....	None	".....	933.....	7
".....	843.....	2	".....	934.....	None
".....	844.....	2	331.....	941.....	18
".....	845.....	11	335.....	951.....	None
".....	845A.....	(See 845)	".....	952.....	1
".....	846.....	4	".....	953.....	None
".....	847.....	None	".....	954.....	None
".....	848.....	None	".....	955.....	None
".....	849.....	None	336.....	961.....	None
".....	850.....	2	".....	962.....	None
".....	851.....	7	337.....	971.....	2
".....	852.....	2	".....	972.....	None
".....	853.....	1	338.....	981.....	None

Every Article of Regulations 45 (1918 Act) and of Regulations 62 (1921 Act) bearing specifically on the war-profits and excess-profits tax is listed in the foregoing table. The first Article is 701.

Missing Article numbers such as 702 to 710 have not yet been used.

*The last Bulletin from which rulings have  
been reproduced hereinbefore and as listed above is*

VOLUME II (1923), No. 27.

*Later Bulletins, since issued (if any), contain no rulings bearing on the  
1918 or 1921 excess-profits tax laws.*

Insert this page to face blue page 401.



give you these dates of acquisition on any appreciable amount of the individual items. I can, however, say that the predecessor corporation started business in 1904 and that additions to plant were made quite extensively in 1907, and probably 90 per cent of the plant on hand July —, 1914, was acquired in those two years.

Referring to paragraph four of your letter asking us to segregate the items which are identified with entries on the books of the predecessor corporation from the items not so identified, it would be a long and difficult task to do this in the form you wish. While the prices paid by the predecessor corporation were used wherever possible, they do not constitute a large per cent of the value, and as it is my understanding that these costs would be, in any event, only for comparative purposes, I believe that the values we have used as of July —, 1914, can be checked to your satisfaction in some other way.

In paragraph five you asked for costs of installation, freight, and cartage. These items were in most cases determined by inspection and by conference with the master mechanic of the company and by using the freight rates known to exist at July —, 1914. To give the detail which you asked for would require an expenditure of money far in excess of anything gained by having these items included at the conservative value which I have shown for these items.

In view of the admitted inability of the appellant to furnish the evidence necessary to enable the Unit properly to check the appraisal, the case has been returned to the Committee for further recommendation.

The action of the Unit has been discussed with the representative of the appellant and the case is, therefore, further considered as on appeal.

The replies of the appellant indicate a total failure to tie up the inventory as of the date as of which the appraisal was made with the books of the corporation and thus to determine either the date of acquisition or the cost of practically 100 per cent of such inventory. Under these circumstances the Committee concurs in the position taken by the Unit that the appraisal submitted in this case is not susceptible of verification within the requirements of T. D. 3367 [¶1265 herein].

KINGMAN BREWSTER

*Chairman Committee on Appeals and Review.*

The year 1910-1911 was a year of great disaster for the people of the United States. The year was marked by a series of floods that were unprecedented in their extent and severity. The floods were caused by a combination of factors, including heavy rains, melting snow, and a series of storms that swept across the country. The floods were particularly devastating in the West, where they caused the destruction of many towns and cities. In the East, the floods were also severe, causing the loss of many lives and the destruction of property. The year 1910-1911 was a year of great suffering for the people of the United States, and it was a year that will be remembered for many years to come.

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## ESTATE TAX.—RUNNING TABLE OF CONTENTS.

## Rulings, Regulations, Opinions and Decisions

## under the

## Estate Tax Laws.

Giving Treasury Decision Number or other Designation, General Subject Content,  
Date of Issue, and Paragraph Reference.

T. D.	Date	Subject	Paragraph
1921 Law Provisions.....			1
Reg. 63	July 27, 1922	Comprehensive regulations, fully indexed (blue index immediately following), and with complete table of contents beginning on page 35.	
2372	Sept. 25, 1916	Notice by others than qualified executor or administrator.....	311
2449	Feb. 13, 1917	Value of U. S. bonds may not be excluded.....	307
2529	Oct. 4, 1917	Household effects.....	256
2705	Apr. 23, 1918	U. S. bonds in payment of tax.....	353
3138	Mar. 3, 1921	Community property in the eight states having community property laws.....	264
3144	Mar. 3, 1921	Receipt of Liberty bonds or Victory notes in payment of tax.....	387
3227	Sept. 8, 1921	Smietanka vs. Ullman. U. S. Circuit Court of Appeals decision, Act of April 4, 1918. Receipt of converted Liberty bonds in payment of tax.....	356
3319	Apr. 5, 1922	Title Guarantee and Trust Co. (Teets) vs. Edwards. U. S. District Court Decision. Bequest or devise in lieu of dower.....	262
3383	Aug. 9, 1922	Department Circular 225 extended and made applicable to receipt of Treasury Notes for Estate Taxes.....	388
Special	June 24, 1920	Tax payment under the 1918 Act may be enforced any time after expiration of the one year period.....	312
Special	June 26, 1920	Transfer of stock: lien on stock and release of lien.....	393
Special	Aug. 21, 1920	U. S. bonds owned by nonresident alien decedent.....	308
Circ. 225	Jan. 31, 1921	Liberty bonds and Victory notes in payment of tax.....	358
Special	Sept. 11, 1922	No certificate releasing lien (waiver) required before transfer of stock of a foreign corporation standing in the name of a nonresident decedent.....	396
Decision	Feb. 28, 1921	U. S. vs. Field. U. S. Supreme Court decision, 1916 Act as amended. Property passing under general power of appointment.....	403
Decision	Apr., 1921	Smietanka vs. Ullman (See T. D. 3227 above.)	
Decision	May 16, 1921	N. Y. Trust Company vs. Eisner. United States Supreme Court decision, 1916 Act. New York transfer taxes, and other inheritance, succession and legacy taxes are not deductible in the determination of net estate subject to Federal estate tax.....	397
Decision	Mar. 21, 1922	Nichols vs. Gaston. U. S. Circuit Court of Appeals decision, 1918 Act. The tax being due and payable one year after decedent's death, injunctive relief against its collection by distraint within the 180 day period thereafter will not be granted.....	317
Decision	Feb. 14, 1922	Title Guarantee and Trust Co. (Teets) vs. Edwards (See T. D. 3319 above.)	

**ESTATE TAX.—RUNNING TABLE OF CONTENTS.—Continued.**

**Rulings, Regulations, Opinions and Decisions  
under the  
Estate Tax Laws.**

Giving Treasury Decision Number or other Designation, General Subject Content,  
Date of Issue, and Paragraph Reference.

T. D.	Date	Subject	Paragraph
Decision	Apr. 10, 1922	Greiner vs. Lewellyn, U. S. Supreme Court. Value of State and municipal bonds to be included in value of gross estate.....	423
Decisions	May 1, 1922	(1) Shwab vs. Doyle.....	425
		(2) Union Trust Co. vs. Wardell.....	444
		(3) Levy vs. Wardell.....	463
		(4) Knox vs. McElligott.....	477
		(1), (2), (3), and (4). The text of the 1916 Act is not to be construed as applying to transfers in contemplation of death, etc., completed before the passage of the Act. (U. S. Supreme Court.)	
Decision	May 16, 1922	Page vs. Polk. U. S. Circuit Court of Appeals decision, 1918 Act.—The tax being due and payable one year after decedent's death, injunctive relief against its collection by distraint within the 180 day period thereafter, will not be granted.....	345
Decision	June 20, 1922	Slocum et al., executors (Sage estate) vs. Edwards.—U. S. District Court Decision, 1918 Act.—Deductible amount of charitable bequests out of residual estate out of which State succession and Federal estate taxes are paid.....	298

The matters listed above are indexed and forward references thereto are embodied in Regulations 63.

The regulations, rulings, etc., listed below, are those issued during 1923.

Decision	Jan. 8, 1923	Slocum et al., executors (Sage Estate); Edwards vs.—U. S. Circuit Court of Appeals affirms District Court decision at June 20, 1922 above.....	488
	June 6, 1923	Art. 21, Reg. 63 (and Art. 25, Reg. 37, 1918 Act) amended—Reservation of Powers.....	E515
Decision	July 3, 1923	Miles vs. Curley, et al.—Maryland collateral inheritance tax was deductible by the estate (1916-1917 Acts)..	E516
3513	Sept. 7, 1923	Receipt of Liberty bonds, Treasury bonds and Treasury notes in payment of estate taxes.....	E532
3514	Sept. 7, 1923	T. D. designation for Miles vs. Curley court decision, ¶E516 above.	
Special	Aug. 17, 1923	California community property, 1916-1917—being comment on the decision of the California Supreme Court in Roberts vs. Wehmeyer.....	E536
Decision	Oct. 8, 1923	Title Guarantee and Trust Co. vs. Edwards; 1916 Act: U. S. Supreme Court.....	E537
3524	Oct. 8, 1923	The Pennsylvania Company for Insurances on Lives and Granting Annuities, et al., Executors (Colfelt) vs. Lederer.—Property passing under general power of appointment: 1918 Act.....	E538

**Insert this page immediately before the blue Estate Tax index.**



## STAMP TAXES.—RUNNING TABLE OF CONTENTS.

## Rulings, Regulations, Opinions and Decisions

under the

## Stamp Tax Law.

Giving Treasury Decision Number or other Designation, General Subject Content,  
Date of Issue, and Paragraph Reference.

T. D.	Date	Subject	Paragraph
Law Provisions.....			3500
Reg. 40	July 8, 1922	Comprehensive regulations relating to stamp tax on issues, sales and transfers of stock and sales of products for future delivery. (See exhaustive Table of Contents beginning on page 709.)	
Reg. 55	June 12, 1922	Comprehensive regulations relating to stamp taxes on documents, fully indexed on the blue-page index at the back of this Stamp Taxes division.....	3743
O. D. 83	March, 1921	Taxable and tax-free issues upon a merger of corporations.	3994
Decision	May 31, "	Marconi Wireless Telegraph Co. vs. Duffy. District Court decision, 1918 Act. Transfer of right to receive stock.....	3998
Special	Feb., "	Transfer of stock from trustee to substituted trustee, when such transfer results wholly from operation of law.....	4000
Special	May 4, "	Transfer of stock to substituted trustee under the Massachusetts law.....	4001
Special	Mar. 15, "	Nominal transfer of title to stock on death of trustee to surviving trustee or trustees.....	4002
Special	Apr. 19, "	Use of rubber stamps on certificates in case of transfers of stock to broker for sale and from broker to purchasing customer.....	4003
Special	Sept. 20, "	Drafts payable in terms of foreign currency, accepted or delivered within U. S. ....	4004
Special	Nov. 4, "	Trade acceptance given in settlement of balance due on open export account is not exempt, as it is not incident to the process of export.....	4005
Special	Mar. 31, "	Extension or renewal of promissory note by extension of mortgage by which secured.....	4008
Special	Apr. 13, "	Drafts covering bunker coal supplied in this country to foreign steamship company.....	4009
Decision	July 14, "	Fidelity Trust Co. vs. Lederer. District Court decision, 1918 Act. Trust certificates issued under Pennsylvania plan held to be taxable as "Certificates of Indebtedness.".....	4010
Special	Jan. 26, 1922	Reliance of original-issue agents on statement of officials of corporation as to "actual value" of its non-par value stock.....	4016
Special	Jan. 26, "	Original issue tax liability on certificate representing more than one share having actual value of less than \$100.....	4019
Special	Feb. 3, "	Transfer of stock owned by a partnership to the individual members thereof.....	4020
Special	May 27, "	Stamps of large denominations in proper aggregate amount may be affixed to permanent corporation record accompanying proxies in lieu of separate stamps to the respective proxies.....	4021
Special	Nov. 4, 1921	Transfer of stock standing in name of brokerage firm, to and into name of successor firm, is taxable.....	4024
Special	Aug. 16, 1922	Transfer of stock from banking institution to its nominee is taxable.....	4026

The matters listed above are indexed.

# STAMP TAXES.—RUNNING TABLE OF CONTENTS.

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Issued herein since January 1, 1923.

Giving Treasury Decision Number or other Designation, General Subject Content,  
Date of Issue, and Paragraph Reference.

The matters listed below are not indexed.

T. D.	Date	Subject	Paragraph
3417	Dec. 16, 1922	Fidelity Trust Co. vs. Lederer. District Court Decision, 1918 Act. Trust Certificates issued under Pennsylvania Plan held to be taxable as "Certificates of Indebtedness".....	4027
Decision	Aug. 18, "	Haverty Furniture Co. vs. U. S. District Court decision, 1918 Act. Installment purchase agreement contracts even though embodying an "agreement to pay" in terms, are not per se promissory notes, and so, are not taxable as such.....	4028
Special	Jan. 31, 1923	Instances of nontaxable transfers from trustee to substituted trustee of legal title to stock because resulting wholly from operation of law, under the laws of New York.....	4032
3446	Mar. 1, 1923	Art. 13, Reg. 40, amended.—Sales and transfers of stock not subject to tax.....	4034
3466	Apr. 13, 1923	Art. 5(g), Reg. 40, amended.—Original stock issues not subject to tax.....	4040
Special	Apr. 28, 1923	Taxability of instruments entitled "Sale of Oil and Gas Royalty", and "Oil and Gas Leases".....	4041
Decision	July 5, 1923	Fidelity Trust Co. vs. Lederer, C. C. of A. decision, 1918 Act Car Trust Certificates issued under the Pennsylvania Plan held not to be taxable as "Certificates of Indebtedness".....	4050
3503	Aug. 2, 1923	Art. 15, Reg. 40, amended.—Memorandum for sales not required to show price per share at which stock is sold	4055
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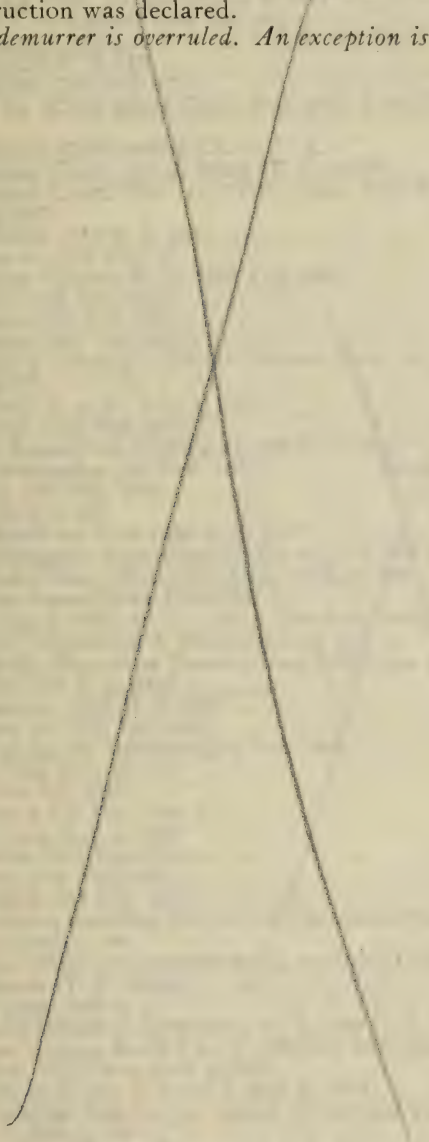






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**Giving Treasury Decision Number or other Designation, General Subject Content,  
Date of Issue, and Paragraph Reference.**

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**Insert this page immediately before the blue Estate Tax index.**



## UNINDEXED SUPPLEMENTARY ESTATE TAX REGULATIONS, ETC.

**E535** 3. For the calculation of accrued interest on the current coupons of bonds and notes tendered in payment of estate or inheritance taxes under this circular, the method outlined in Exhibit B [¶383] to Department Circular No. 225, dated January 31, 1921, should be followed. Interest tables at the various rates borne by the various issues, or for other or future issues, may be obtained from the Treasury Department, Division of Loans and Currency, Washington, upon request. (Second Supplement to Department Circular No. 225 appended to T. D. 3513, ¶E532, signed by S. P. Gilbert, Jr., Acting Secretary of the Treasury, and dated July 31, 1923.)

**E536 California Community Property (1916-1917 Acts).**—The California Supreme Court holds, no question of Federal taxation being involved, however, in *Roberts vs. Wehmeyer* (August 17, 1923), that the husband is the owner of the community property. Judge Lawlor in the course of his opinion states that “we are not unmindful of the two decisions rendered in the case of *Blum vs. Wardell*, one by the United States District Court, 270 Fed. 309, and the other by the United States Circuit Court of Appeals, 276 Fed. 226,” holding that the wife’s half of the community property should not be included in the decedent husband’s gross estate for the purposes of the Federal estate tax (1916 Act). Judge Lawlor, continuing, says: “We agree with the decision of the Circuit Court of Appeals in so far as it is based on the interpretation of the Inheritance Tax Act of 1917 (California) to the effect that the part of the community property passing to the wife should not be subject to such tax.”—The Corporation Trust Company.

**E537 Deductibility of New York State transfer (inheritance) tax as “a charge against the estate;” bequest or devise in lieu of dower: 1916 Act.**—[In the United States Supreme Court on October 8, 1923, *Title Guarantee and Trust Company vs. Edwards*, No. 40, October 1923 Term (below, 290 Fed. 617, ¶262 herein), was dismissed “for want of jurisdiction,” citing *Farrell vs. O’Brien* (199 U. S. 89, 100), *Toop vs. Ulysses Land Company* (237 U. S. 580), and *Piedmont Power and Light Company vs. Town of Graham* (253 U. S. 193, 195). *Per curiam*.—The Corporation Trust Company.]

1. The following is a list of the names of the persons who have been appointed to the various positions in the Department of Agriculture, for the year 1900. The names are given in alphabetical order, and the positions are given in the order in which they were appointed.

2. The following is a list of the names of the persons who have been appointed to the various positions in the Department of Agriculture, for the year 1900. The names are given in alphabetical order, and the positions are given in the order in which they were appointed.

3. The following is a list of the names of the persons who have been appointed to the various positions in the Department of Agriculture, for the year 1900. The names are given in alphabetical order, and the positions are given in the order in which they were appointed.

4. The following is a list of the names of the persons who have been appointed to the various positions in the Department of Agriculture, for the year 1900. The names are given in alphabetical order, and the positions are given in the order in which they were appointed.



## STAMP TAX REGULATIONS.

(Decision.)

September 22, 1922.

The issue of four shares of \$25 par value for each outstanding share of \$100 par value, pursuant to charter amendment reducing par value of shares, is not subject to tax as original issue on reorganization.

DISTRICT COURT FOR THE NORTHERN DISTRICT OF OHIO  
EASTERN DIVISION

The Trumbull Steel Company, Plaintiff,

vs.

C. F. Routzahn, Collector of Internal Revenue, Defendant.

**4072** WESTENHAVER, District Judge:—The sole question presented is what issues of stock by a corporation are subject to the stamp tax imposed by Secs. 1100 and 1107, Schedule A, Par. 2, War Revenue Act approved Nov. 23, 1921, (42 Stat. 227, 301, 303; Supplement 1923 U. S. Comp. Stat. Sec. 6318i, 6318p, Schedule A, Par. 2).

**4073** Prior to August 16, 1920, The Trumbull Steel Company had issued and outstanding, 131,681 shares of stock evidenced by certificates of par value of \$100 each. On that date, pursuant to Secs. 8719-8722 G. C. of Ohio, the company amended its articles of incorporation, changing the par value of each share of \$100 to \$25. The outstanding certificates were thereafter called in and four new certificates for each of the old were issued. No other change in stock ownership or stock privileges or corporate organization was made. A tax of five cents on each \$100 par value of the new certificates was levied and assessed, paid under protest, and application for a refund made to the Commissioner of Internal Revenue, and by him refused. Hence this action.

**4074** Secs. 1100 and 1107, Revenue Act of 1921 are precisely the same as the corresponding sections of War Revenue Act of 1918 approved Feb. 24, 1919 (40 Stat. 1057, 1133, 1135). In all provisions pertinent to this controversy, these two revenue acts are precisely the same as the War Revenue Act of 1917 approved Oct. 3, 1917, (40 Stat. 300, 319, 321) and, as was pointed out in *Edwards v. Wabash Ry. Co.* (2 C. C. A.) 264 Fed. 610, the provisions of the War Revenue Act of 1917 were substantially the same, so far as they pertain to this subject matter, as corresponding provisions in the Spanish War Revenue Act approved June 13, 1908 (30 Stat. 458) and of the Emergency War Revenue Act approved Oct. 22, 1914 (38 Stat. 753). This being true, a construction given to the provisions of the War Revenue Act of 1917 or of the two other revenue acts referred to prior to the re-enactment of the same provisions in the Revenue Act of 1921, is controlling, upon the familiar rule that the re-enactment by Congress without change of a statute which has previously received a certain construction, whether judicial or departmental, is an adoption by Congress of such construction. *Sewing Machine Companies Case*, 18 Wall. 553, 584; *Kepner v. United States*, 195 U. S. 100, 121; *United States v. G. Falk & Bro.*, 204 U. S. 143, 152; *United States v. Cerecedo Hermanos y Campana*, 209 U. S. 337, 339.

**4075** The Act in question imposed a stamp tax of five cents on each \$100 of face value or fraction thereof of capital stock. The language describing the same is "on each original issue, whether on organization or reorganization, of certificates of stock \* \* \* by any corporation."

## STAMP TAX REGULATIONS.

Transfers, sales, or reissue of certificates are subject to a different tax and are provided for in other paragraphs of Sec. 1107. Hence the question is, what is an original issue of certificates? Or, differently stated, what is an original issue on reorganization?

**4076** These questions were fully considered in *Edwards v. Wabash Ry. Co. supra*. It arose under War Revenue Act of 1917 and was decided Feb. 8, 1920. The Wabash Ry. Co. had outstanding two classes of preferred stock and also common stock. It called in one class of preferred stock and converted it part into preferred and part into common and issued new certificates to the holders thereof, conferring new and different rights and privileges in the corporate property and management. It was held that this readjustment of the stock of the corporation was not an original issue either on organization or reorganization, and that the new certificates were not subject to the documentary stamp imposed by the War Revenue Act of 1917. This readjustment of corporate rights and privileges among stockholders was more fundamental and more worthy to be called a reorganization of the corporation than the changes effected by the plaintiff herein among its stockholders. In the former case the rights and privileges of the stockholders were, as between themselves, and in the assets of the corporation, substantially changed and readjusted, whereas in the present case no change was effected but each stockholder at the end of the process had merely four certificates evidencing precisely the same rights and privileges as were previously evidenced by a single certificate.

**4077** Upon the principle and authorities above stated, this case is controlling. It is pointed out in the opinion that the provisions of the Spanish War Revenue Act imposing a stamp tax on stock certificates was given a departmental construction excluding therefrom re-issues where there was no change of ownership but merely a substitution in the hands of the same stockholder of certificates for one class of stock in lieu of certificates for another class (T. D. 20694, Feb. 7, 1899); and also that a like departmental construction had been given to the corresponding provisions of the Emergency War Revenue Act of 1914 (T. D. 2051, March 9, 1914); and that this departmental construction thus declared and acquiesced in was not changed until 1918 (T. D. 2752, Aug. 14, 1918). It was held that the re-enactment of the same language in the War Revenue Act of 1917 after this departmental construction had been established, was the equivalent of an adoption by Congress of that construction. In addition thereto we now have the re-enactment by Congress of the exact language of the War Revenue Act of 1917 after a judicial construction to the same effect.

**4078** In view of these considerations, whatever doubt might originally or otherwise exist as to the provision in question, *Edwards v. Wabash Ry. Co.* should be followed. Nothing in the way of original discussion can be profitably added to the carefully considered opinion of Circuit Judge Rogers. The conclusion now reached accords with the holding of District Judge Hickenlooper, Southern District of Ohio, July 24, 1923, in *American Laundry Mach. Co. v. Dean* [¶4063, herein], and of District Judge Knox, August 1, 1923, in *West Virginia Pulp & Paper Co. v. Bowers* [¶4062, herein]. Such also seems to be the purport of *Holmes Federal Taxes*, 1923 Edition, pp. 1392-4.

**4079** What is a reorganization of a corporation such as makes new certificates as original issue subject to the stamp tax, need not be further considered. Cook on Corporations, 6th Ed., Sec. 883, attempts a definition



**Perpetual Check List**  
**Supplementary Rulings Reprinted from the Internal Revenue Bulletins.**

The Supplementary Rulings are printed on the pages immediately preceding.

**The Foreword to the Supplementary Rulings should be read.**

**Key.**—The word “none,” in the column headed “Last Ruling,” signifies in each case that there are no special rulings bearing on the particular Article of Regulations 45 (1918 Act) or of Regulations 62 (1921 Act).

The numeral, in each case, shows *how many* serially numbered special rulings bearing on the particular Article have been reproduced and indicates *the last* serial number of the group. These serial numbers appear in bold face type at the *end* of the special rulings themselves, within the Supplement.

**Caution.**—To the extent of the imposition of the excess-profits tax for 1921, the 1918 and 1921 laws are identical, except that domestic corporations entitled to the benefits of Section 262 of the 1921 Act (§1083) are grouped with foreign corporations for the purposes of the 1921 excess-profits tax. To much the same extent, with like qualifications, the provisions of Regulations 62 (1921 Act) are essentially identical (there are frequent verbal changes) to the provisions of Regulations 45 (1918 Act). The numbering of the Articles of Regulations 62 (1921 Act) is the same as that of the respective corresponding Articles of Regulations 45 (1918 Act), except as noted below. It follows then, that, except as noted below, for the purposes of the Supplementary Bulletin Rulings, the Article reference number is the same under either Act.

Reg. 62 (1921 Act)	Reg. 45 (1918 Act)
No corresponding Article.....	to Article 712
Article 712 is the same as, therefore refer to, Article 713	
“ 713 “ “ “ “ “ “ “ “	714
“ 714 “ “ “ “ “ “ “ “	715
“ 715 “ “ “ “ “ “ “ “	716
No corresponding Article.....	to Article 717
Article 716 is the same as, therefore refer to, Article 719	
“ 717 “ “ “ “ “ “ “ “	718
“ 718 “ “ “ “ “ “ “ “	720
No corresponding Article.....	to Article 869
Article 869 is the same as, therefore refer to, Article 870	
“ 870 “ “ “ “ “ “ “ “	871

**Otherwise**

Art. of Reg. 62 is same as, therefore refer to, same numbered Art. of Reg. 45  
(The list is always up-to-date.)

Law Section	Article Number	Last Ruling	Law Section	Article Number	Last Ruling
300.....	701.....	None	302.....	732.....	1
301.....	711.....	1	“	733.....	None
“	712.....	None	303.....	741.....	2
“	713.....	None	“	742.....	None
“	714.....	11	“	743.....	None
“	715.....	2	304.....	751.....	None
“	716.....	None	“	752.....	1
“	717.....	None	“	753.....	None
“	718.....	None	305.....	761.....	None
“	719.....	1	310.....	771.....	1
“	720.....	None	311.....	781.....	3
302.....	731.....	1	“	782.....	None

Law Section	Article Number	Last Ruling	Law Section	Article Number	Last Ruling
311.....	783.....	1	326.....	854.....	2
"	784.....	None	"	855.....	1
"	785.....	None	"	856.....	None
312.....	791.....	4	"	857.....	7
320.....	801.....	1	"	858.....	10
"	802.....	1	"	859.....	2
325.....	811.....	2	"	860.....	1
"	812.....	3	"	861.....	None
"	813.....	10	"	862.....	4
"	814.....	None	"	863.....	None
"	815.....	9	"	864.....	None
"	816.....	1	"	865.....	None
"	817.....	1	"	866.....	None
"	818.....	3	"	867.....	None
326.....	831.....	43	"	868.....	None
"	832.....	None	"	869.....	1
"	833.....	5	"	870.....	1
"	834.....	1	"	871.....	1
"	835.....	4	327.....	901.....	30
"	836.....	18	328.....	911.....	2
"	837.....	6	"	912.....	3
"	838.....	10	"	913.....	1
"	839.....	4	"	914.....	2
"	840.....	10	330.....	931.....	4
"	841.....	5	"	932.....	1
"	842.....	None	"	933.....	7
"	843.....	2	"	934.....	None
"	844.....	2	331.....	941.....	18
"	845.....	10	335.....	951.....	None
"	845A.....	(See 845)	"	952.....	1
"	846.....	4	"	953.....	None
"	847.....	None	"	954.....	None
"	848.....	None	"	955.....	None
"	849.....	None	336.....	961.....	None
"	850.....	2	"	962.....	None
"	851.....	7	337.....	971.....	2
"	852.....	2	"	972.....	None
"	853.....	1	338.....	981.....	None

Every Article of Regulations 45 (1918 Act) and of Regulations 62 (1921 Act) bearing specifically on the war-profits and excess-profits tax is listed in the foregoing table. The first Article is 701.

Missing Article numbers such as 702 to 710 have not yet been used.

*The last Bulletin from which rulings have  
been reproduced hereinbefore and as listed above is*

VOLUME II (1923), No. 26.

*Later Bulletins, since issued (if any), contain no rulings bearing on the  
1918 or 1921 excess-profits tax laws.*

Insert this page to face blue page 401.



**Revenue Act of 1921.**

I ('22) 51-643: I. T. 1532.

On January 1, 1921, the M Company's business was the property of an individual. On September 1, 1921, a corporation having the same name as that under which this business had been previously conducted took over the entire assets and liabilities of the business. The individual income tax return of the individual owner included the income from the business for the period from January 1 to August 31, 1921, while a corporation income and profits tax returns was filed by the corporation for the period from September 1 to December 31, 1921. In preparing an amended return in which the income from the business for the entire year was to be returned as the income of the corporation, under the provisions of section 229 of the Revenue Act of 1921, it was found that the withdrawal account of the former owner of the business for the period from January 1 to August 31, 1921, included an item paid by him to the collector of internal revenue in settlement of his individual income tax for the year 1920.

The question was raised as to whether the entire withdrawal account of the individual owner should be considered as a dividend paid to him by the corporation or whether the Federal income tax item should be eliminated from the withdrawal account and be considered as an item of Federal income tax paid and not as a dividend.

Held, that the item of the individual owner's withdrawal account representing the amount paid in discharge of his individual Federal income tax for 1920 should be prorated so as to represent amounts which will be proportionate to the amount of his net income for 1920 which was derived from the M Company's business and to the remaining amount of his net income which was derived from other sources, respectively.

The portion of the withdrawal made for income tax payment which is proportionate to the individual owner's net income derived from the M Company's business should not be considered as a dividend received by him from the corporation and it is not subject to tax as such. It is to be considered as a payment from the capital of the M Company's business as at December 31, 1920, and must be excluded from the amount of the assets received by the corporation in determining its invested capital at January 1, 1921.

The balance of the withdrawal made for the income tax payment which is proportionate to the individual owner's net income derived from sources other than the M Company's business, if any, is to be considered as a dividend paid by the corporation during 1921 and will be taxable as such.

All other funds withdrawn by the individual owner for personal use during the period from January 1 to August 31, 1921, must be considered as dividends paid to him by the corporation.

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II ('23) 1-688: I. T. 1559.

**Revenue Act of 1921.**

A corporation suffered an operating loss during its first fiscal year which ended in 1920, but made a profit for the fiscal year ended in 1921, upon which it paid an income tax. This profit, however, was not sufficient to wipe out the operating loss of the preceding year.

The corporation is not required to reduce its invested capital for the fiscal year beginning in 1921 and ended in 1922 on account of the income-tax

payment made during such year, but is entitled to the full capital paid in as invested capital without reduction for the operating loss or for the income-tax payment.

In filing its return for the fiscal year begun in 1921 and ended in 1922, care should be taken to state in Schedule H of the return the reason why there is no adjustment of invested capital on account of the income-tax payment for the preceding year.

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the property was to be held in trust by the N Company and at the expiration of the period was to be conveyed to the appellant by a good and sufficient deed, provided all of the conditions set out in the agreement of 1911 had been complied with. The contract was carried out and in the year 1921 the land and buildings were deeded to the taxpayer and a release given by the N Company for any and all contractual rights which it held under the agreement.

The appellant contends that for all practical purposes the cash and land were paid into the corporation for use in its business without any financial consideration or interest charges, and that the 20x dollars should be allowed as paid-in surplus under the provisions of article 63 of Regulations 41.

The Committee has carefully considered the arguments that have been advanced and has reached the conclusion that under no construction of the regulations could this cash and tangible property be regarded as having been paid in to the appellant corporation at any time prior to the full compliance with all of the terms of the agreement entered into in 1911. The appellant corporation could, at any time during this period, have failed or refused to comply with one or more of the conditions, and had this been done all of the property would have reverted to the N Company. The provisions of the law and regulations relating to paid-in surplus do not contemplate any such contingent interest with respect to the property paid in.

It is therefore recommended, in the appeal of the M Company, that its claim for paid-in surplus of 20x dollars be denied and that the action of the Income Tax Unit be sustained.

KINGMAN BREWSTER,  
*Chairman Committee on Appeals and Review.*





Paid in or earned surplus and undivided profits not including surplus and undivided profits earned during the year.

The questions involved here rest on whether the proportionate amounts of annual earned surplus credited to the respective individual surplus account of the several stockholders were dividends, or in whole or in part earned surplus.

Article 858, Regulations 45, in so far as pertinent here reads as follows:

A dividend other than a stock dividend affects the computation of invested capital from the date when the dividend is payable and not from the date when it is declared, except that where no date is set for its payment the date when declared will be considered also the date when payable for the purpose of this article. \* \* \* From the date when any dividend is payable the amount which the several stockholders are entitled to receive will be treated as if actually paid to them, whether or not it is so paid in fact, and the surplus and undivided profits, either of the taxable year or of the preceding years, will in accordance with the foregoing provisions be deemed to be reduced as of that date by the full amount of the dividend.

The statute of Connecticut as to dividends follows the general form as that of most States. It prohibits a corporation from paying any dividend or from making any other distribution of its assets except from its net profits or actual surplus, unless in accordance with the law as to the reduction of stock or upon dissolution.

While the resolutions referred to do not specifically refer to the amounts credited to the so-called individual surplus accounts as dividends, the purpose is clear that it was intended to make available to each stockholder at least a large part if not all of the amounts so credited. This is evidenced by the large withdrawals without any further corporate action. While the usual and proper way to appropriate corporation profits to stockholders is by formally declaring a dividend, it has been very generally held that there may be a division of profits among stockholders without the formality of declaring a dividend, and that such a division is the equivalent of a dividend. (*Smith v. Moore*, 199 Fed., 689; *Hartley v. Pioneer Iron Works*, 73 N. E., 576 (N. Y.)) And it has been held that if the directors ascertain the profits and set apart the portion thereof that is to be divided, a failure to observe the forms prescribed by law as to the time, place and manner of declaring them is immaterial. (*Breslin v. Fries-Breslin Co.*, 58 Atl., 313 (N. J.)) This is the law in Connecticut. (*Cogswell v. Second National Bank*, 60 Atl., 1059, affirmed in 204 U. S., 1.)

In the instant case the directors having ascertained the profits, and set apart certain sums which were actually credited to the individual stockholders, all matters of form are immaterial. The evidence shows that at stated times the specific things necessary to warrant a declaration of dividends were done and that the profits actually made were set apart for distribution among the stockholders. This is the essence of the declaration of a dividend, so far as it results in segregating a portion of the property of the company for the use of the stockholders. Therefore the corporation, as such, had no property interest in the money thus set apart. (*Breslin v. Fries-Breslin Co.*, supra; *Barnes v. Spencer & Barnes Co.*, 127 N. W., 752 (Mich.); *Cogswell v. Second National Bank*, supra (Conn.)) The effect of the declaration of a dividend is at once the establishment of a debt due from the corporation to each stockholder. (*Boardman v. Mansfield*, 66 Atl., 169 (Conn.); *Bishop v. Bishop*, 71 Atl., 583 (Conn.))

The amounts credited to the accounts of the respective stockholders were freely drawn upon and the amounts so credited reported as income by the individual stockholders when credited to their accounts. These are circumstances which are of great persuasive force in reaching a conclusion as to how the individual stockholders themselves considered the amounts so credited.

It is, therefore, the opinion of this office that the proportionate amounts of the annual earned surplus credited to the respective individual surplus accounts of the several stockholders were dividends, and that such surplus accounts were in effect debts owing at all times by the corporation to its stockholders, any withdrawal by individual stockholders merely being a debit against the proper individual surplus account. It follows that for the years 1917 and 1918 the net credit balances of individual surplus accounts can not be included in the invested capital of the M Company.

In accordance with the above opinion of the Solicitor, in which the Committee concurs, it is recommended that the action of the Income Tax Unit in holding that certain amounts standing as credits to the individual surplus accounts of stockholders on January 1, 1917, and January 1, 1918, represented dividends owing to its stockholders and not, as contended by the appellant, earned surplus which could properly be included in invested capital, be sustained, and, accordingly, that the appeal be denied.

II ('23)-2-722; I. T. 1582.\*

**Revenue Act of 1918.**

A corporation succeeded a partnership on January 1, 1918, and took over the assets and liabilities of the partnership at their book value. One of the items taken over was a reserve for taxes which represented the amount of the excess-profits tax due by the partnership and the amount of the income taxes due by the individual partners. The corporation, in opening its balance sheet on January 1, 1918, set up this reserve for taxes and claimed it as a part of its invested capital as of January 1, 1918.

Held, that the reserve for taxes when transferred from the partnership to the corporation represented borrowed capital in the possession of the corporation and that, in accordance with the provisions of section 326(b) of the Revenue Act of 1918, it could not be included in the invested capital of the corporation.

\*This Ruling No. 10 has been revoked by A. R. R. 2190 for which see herein at Sec. 326.—Art. 845.—8, Ruling No. 11.

**10**



Paid in or earned surplus and undivided profits not including surplus and undivided profits earned during the year.

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Held, that the reserve for taxes when transferred from the partnership to the corporation represented borrowed capital in the possession of the corporation and that, in accordance with the provisions of section 326(b) of the Revenue Act of 1918, it could not be included in the invested capital of the corporation.

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## UNINDEXED SUPPLEMENTARY ESTATE TAX REGULATIONS, ETC.

**E535** 3. For the calculation of accrued interest on the current coupons of bonds and notes tendered in payment of estate or inheritance taxes under this circular, the method outlined in Exhibit B [¶383] to Department Circular No. 225, dated January 31, 1921, should be followed. Interest tables at the various rates borne by the various issues, or for other or future issues, may be obtained from the Treasury Department, Division of Loans and Currency, Washington, upon request. (Second Supplement to Department Circular No. 225 appended to T. D. 3513, ¶E532, signed by S. P. Gilbert, Jr., Acting Secretary of the Treasury, and dated July 31, 1923.)

**E536 California Community Property (1916-1917 Acts).**—The California  
 117 Supreme Court holds, no question of Federal taxation being involved,  
 127 however, in *Roberts vs. Wehmeyer* (August 17, 1923), that the  
 285 husband is the owner of the community property. Judge Lawlor in  
 the course of his opinion states that "we are not unmindful of the  
 two decisions rendered in the case of *Blum vs. Wardell*, one by the United  
 States District Court, 270 Fed. 309, and the other by the United States Circuit  
 Court of Appeals, 276 Fed. 226," holding that the wife's half of the  
 community property should not be included in the decedent husband's gross  
 estate for the purposes of the Federal estate tax (1916 Act). Judge Lawlor,  
 continuing, says: "We agree with the decision of the Circuit Court of Appeals  
 in so far as it is based on the interpretation of the Inheritance Tax Act of  
 1917 (California) to the effect that the part of the community property  
 passing to the wife should not be subject to such tax."—The Corporation Trust  
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Koller: U. S. vs. (287 Fed. 418).....	(Admissions Tax)	6837
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W. U. Telegraph Co. vs. D. L. & W. R. R. Co. (282 Fed. 925).....	(Tel. and Tel. Taxes) note at	5525
Dec. 1922 Cum. Bull. p. 272		
Walker: Bankers & Planters Mutual Insurance Association vs. (279 Fed. 53) (Insurance Tax) .. June 1922 Cum. Bull. p. 259.		
Wardell: Levy vs. (258 U. S. 542).....	(Estate Tax)	463
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Washington Water Power Co. vs. U. S. (56 Ct. Clms.—Opinion No. 34092).....	(Capital Stock Tax)	3105
Wehmeyer: Roberts vs. (California Supreme Court, Aug. 17, 1923).....	(Bearing on Estate Tax)	E536
West Virginia Pulp & Paper Co. vs. Bowers (U. S. D. C., Aug. 1, 1923).....	(Stamp Taxes)	4062
Woods vs. Lewellyn (289 Fed. 498).....	(Excess-Profits Tax)	1327
Young vs. U. S. (269 Fed. 58) (Excess Profits Tax) .. June 1921 Cum. Bull. p. 357.		



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Reg. 40	July 8, 1922	Comprehensive regulations relating to stamp tax on issues, sales and transfers of stock and sales of products for future delivery. (See exhaustive Table of Contents beginning on page 709.)	
Reg. 55	June 12, 1922	Comprehensive regulations relating to stamp taxes on documents, fully indexed on the blue-page index at the back of this Stamp Taxes division.....	3743
O. D. 83 Decision	March, 1921 May 31, "	Taxable and tax-free issues upon a merger of corporations. Marconi Wireless Telegraph Co. vs. Duffy. District Court decision, 1918 Act. Transfer of right to receive stock. ....	3994 3998
Special	Feb., "	Transfer of stock from trustee to substituted trustee, when such transfer results wholly from operation of law.....	4000
Special	May 4, "	Transfer of stock to substituted trustee under the Massachusetts law.....	4001
Special	Mar. 15, "	Nominal transfer of title to stock on death of trustee to surviving trustee or trustees.....	4002
Special	Apr. 19, "	Use of rubber stamps on certificates in case of transfers of stock to broker for sale and from broker to purchasing customer.....	4003
Special	Sept. 20, "	Drafts payable in terms of foreign currency, accepted or delivered within U. S. ....	4004
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Special	Apr. 13, "	Drafts covering bunker coal supplied in this country to foreign steamship company.....	4009
Decision	July 14, "	Fidelity Trust Co. vs. Lederer. District Court decision, 1918 Act. Trust certificates issued under Pennsylvania plan held to be taxable as "Certificates of Indebtedness." .....	4010
Special	Jan. 26, 1922	Reliance of original-issue agents on statement of officials of corporation as to "actual value" of its non-par value stock.....	4016
Special	Jan. 26, "	Original issue tax liability on certificate representing more than one share having actual value of less than \$100.....	4019
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Special	Nov. 4, 1921	Transfer of stock standing in name of brokerage firm, to and into name of successor firm, is taxable.....	4024
Special	Aug. 16, 1922	Transfer of stock from banking institution to its nominee is taxable.....	4026

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Date of Issue, and Paragraph Reference.

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T. D.	Date	Subject	Paragraph
3417	Dec. 16, 1922	Fidelity Trust Co. vs. Lederer. District Court Decision, 1918 Act. Trust Certificates issued under Pennsylvania Plan held to be taxable as "Certificates of Indebtedness".....	4027
Decision	Aug. 18, "	Haverty Furniture Co. vs. U. S. District Court decision, 1918 Act. Installment purchase agreement contracts even though embodying an "agreement to pay" in terms, are not per se promissory notes, and so, are not taxable as such.....	4028
Special	Jan. 31, 1923	Instances of nontaxable transfers from trustee to substituted trustee of legal title to stock because resulting wholly from operation of law, under the laws of New York.....	4032
3446	Mar. 1, 1923	Art. 13, Reg. 40, amended.—Sales and transfers of stock not subject to tax.....	4034
3466	Apr. 13, 1923	Art. 5(g), Reg. 40, amended.—Original stock issues not subject to tax.....	4040
Special	Apr. 28, 1923	Taxability of instruments entitled "Sale of Oil and Gas Royalty", and "Oil and Gas Leases".....	4041
Decision	July 5, 1923	Fidelity Trust Co. vs. Lederer, C. C. of A. decision, 1918 Act Car Trust Certificates issued under the Pennsylvania Plan held not to be taxable as "Certificates of Indebtedness".....	4050
3503	Aug. 2, 1923	Art. 15, Reg. 40, amended.—Memorandum for sales not required to show price per share at which stock is sold	4055
Special	May 23, 1923	Rate of transfer tax where stock is sold after authorization of exchange of new par value stock for existing no par value stock.....	4056
Decision	Aug. 1, 1923	West Virginia Pulp & Paper Company vs. Bowers.—Issue of four \$25 shares in exchange for each outstanding \$100 share.....	4062
Decision	July 24, 1923	American Laundry Machinery Company vs. Dean, Collector; and Procter and Gamble Company vs. Dean, Collector.—Issue of a number of shares of smaller par value in exchange for each outstanding share and aggregating the par value thereof, held to be not subject to tax.....	4063

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## EXCESS PROFITS TAX.—RUNNING TABLE OF CONTENTS.

Rulings, Regulations, Opinions and Decisions  
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## War-Profits and Excess-Profits Tax Laws.

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T. D.	Date	Subject	Paragraph
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3367	July 10, 1922	Art. 836, Reg. 45, amended.—Tangible property paid in; value in excess of par value of stock	1265
Special	Mar. 23, 1921	Relief for 1919 under Sec. 328 not determined: computation and payment of tax for 1920	861
3220	Aug. 26, "	Amended returns required within 90 days when inflated values have been used in determining invested capital	865
Mim. 2848	Oct. 19, "	Interpretation of the foregoing	869
3243	Nov. 14, "	Extension of time for foregoing	875
A. R. M. 106	Feb. 26, "	Surplus and undivided profits: Adjustments because of alleged failure to charge off depreciation	877
Special	July 6, "	Explanation of the foregoing	879
Special	Nov. 1, "	Supplementing the foregoing	885
Decision	May 16, "	La Belle Iron Works vs. U. S. U. S. Supreme Court decision, Act of 1917. Invested capital	889
Decision	Nov. 9, 1920	DeLaski & Thropp Circular Woven Tire Co. vs. Iredell, District Court decision, Act of 1917. A corporation whose entire income is derived from royalties on patents in which it has no investment is entitled to assessment under Section 209 as being engaged in a trade or business having no invested capital or not more than a nominal capital	913
Decision	Apr. 19, 1921	Lincoln Chemical Co. vs. Edwards. District Court decision, 1917 Act. Additions to surplus account: Earned surplus expended in developing and improving a secret process, or used to repay borrowed money so expended	926
Decision	Dec. 15, "	(Above affirmed, ¶1300.) Cartier-Holland Lumber Co. vs. Doyle. U. S. Circuit Court of Appeals decision, 1917 Act. Borrowed capital in relation to the "no invested capital or not more than a nominal capital" provision of Sec. 209 of the 1917 Act	943
Decision	Mar. 10, 1922	Martin vs. Edwards. U. S. District Court decision, 1917 Act. Invested capital: Selling Agent: Taxability under Sec. 209 of the 1917 Act	968

The matters listed above are fully indexed on the blue index following page 400.

For running table of contents of matters relating to the 1921 Excess Profits Tax Law specially, and to other matters issued since the passage of that Act, see  
Excess-Profits Tax Supplementary Page 2, over.

# EXCESS PROFITS TAX.—RUNNING TABLE OF CONTENTS.

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### War-Profits and Excess-Profits Tax Laws.

Giving Treasury Decision Number or other Designation, General Subject Content,  
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T. D.	Date	Subject	Paragraph
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The regulations, rulings, etc., listed immediately below, were issued during 1922.

1921 Law Provisions.....	1000
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Reg. 6s, Pt. II-B Regulations under 1921 Act (1922 Edition). Promulgated February 15, 1922. Released for publication March 1, 1922.....Page				425
3367	July 10, 1922	Art. 836, Reg. 62, amended.—Tangible property paid in; value in excess of par value of stock.....	1265	
Special	Jan. 16, "	Allocation of tax: partnerships and corporations in consolidated cases under 1917-1921 Acts.....	1266	
Special	April, "	Consolidated returns for 1917 (A. R. R. 855).....	1273	
Special	June, "	Consolidated returns for 1917 (A. R. R. 942).....	1274	
3389	Aug. 24, "	Arts. 77 and 78, Reg. 41 (1917 Act) amended.—Consolidated returns, 1917.....	1289	

The matters listed above are fully indexed on the blue index beginning opposite.

Decision	Jan. 2, 1923	Greenport Basin and Construction Co. vs. U. S., 1917 Act.—Application of the deduction in the computation of the tax.....	1297
3429	" 19, "	T. D. designation for the Greenport Basin and Construction Co. vs. U. S. decision (see Jan. 2, 1923, above) reported at ¶1297.	
Decision	Feb. 5, "	Lincoln Chemical Co. vs. Edwards, 2d. C. C. of A. decision, 1917 Act.—Additions to surplus account: Earned surplus expended in developing and improving a secret process, or used to repay borrowed money so expended.....	130
3458	Apr. 4, "	(This T. D. reproduces, merely, the decision in Lincoln Chemical Company case, ¶1300 above.)	
Decision	Mar. 14, "	Woods vs. Lewellyn, 1917 Act (tax on individuals).—Commissions on certain renewal insurance premiums	1327
Decision	July 5, "	De Laskie and Thropp Circular Woven Tire Co.: Iredell vs. 3d C. C. of A. decision, 1917 Act. Nominal capital vs. invested capital: patent royalties.....	1328
Decision	May 15, "	Beam vs. Hamilton, 1917 Act.—Failure to file separate excess profits tax return.....	1333

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**WAR-PROFITS AND EXCESS-PROFITS TAX REGULATIONS, ETC.—1922-1923.**

as provided by the Section, engaged in a trade or business having a nominal capital. It was not a producer or manufacturer but its entire business was simply to collect and distribute the rental or royalty charged for use of its patents and, as it may, in accordance with said Section, be assessed with "a tax equivalent to eight per centum of the net income of such trade or business" it follows by the terms of the section this shall be "in lieu of the tax imposed by section two hundred and one."

**1332** The Court below having found as a fact—a finding in which we concur—that the trade or business of the Plaintiff had no invested capital, and such being the plain wording of the statute, it follows that an attempt by departmental construction to theoretically swell that nominal capital into a large amount, simply because its business on its nominal capital proved highly remunerative, is at variance with the taxing statute and with the principle that the right to impose taxation must have clear statutory warrant and that doubtful constructions must be resolved in favor of the taxpayer.

*The judgment below is affirmed.*

(Decision.)

1917 Tax on Individuals.

**1333** Failure to make and file separate excess profits tax return under the Act of October 3, 1917, subjects taxpayer to fifty per cent penalty.

—[Comment: In *Beam vs. Hamilton*, Collector, Circuit Court of Appeals, Sixth Circuit (289 Fed. 9), decided May 15, 1923, the plaintiff seeks to have set aside a judgment rendered in favor of the collector in a suit to recover a penalty (50% of the excess profits tax found due) for alleged failure to make separate return for excess profits tax purposes of income from his personal business as a distiller received during 1917 no accounting of which was carried forward in his income tax return of salary and dividends otherwise received. Judge Knappen held that " \* \* \* we are unable to agree with plaintiff's contention that, because Schedule B was so left blank, and plaintiff thereby (implied only) made a return that he was not engaged in a business with invested capital, and that he did not owe any excess profits tax, he thereby made a return within the meaning of the excess profits title, although the return so impliedly made on Form 1040 was untrue; nor with the further contention that, unless the return actually made was willfully false or fraud-

incidental to the conduct of the plaintiff's business and was used entirely as a fund from which to advance salaries, wages, etc., and to provide office furniture, accommodations and equipment.

10. In compliance with the provisions of the Act of Congress entitled 'An Act to Provide Revenue to Defray War Expenses and other Purposes,' approved October 3, 1917, plaintiff made due returns to the defendant of its annual net income for the twelve (12) months ended December 31, 1917, and paid the income and excess profits taxes due thereunder, in accordance with the provisions of Section 209 of the said Act, whereby the excess profits tax was levied and assessed upon corporations employing no invested capital or not more than a nominal capital. The plaintiff's contention in this respect was disallowed by the Commissioner of Internal Revenue, and after various letters had been exchanged and a hearing had in Washington, the plaintiff was notified by the defendant in August, 1919, that additional income and excess profits taxes for the year 1917 had been assessed against it in the sum of \$16,969.45, which amount had been arrived at upon the basis of a fictitious capital constructed under Section 210 of the said Act and an application of the rates prescribed by Section 201 of the Act for corporations employing capital."

ulent, as the court below found it was not, plaintiff cannot be subject to the penalty for failure to make another return, as to which the liability is not conditioned upon fraudulent action. Not only was the excess profits tax a separate, distinct, and then novel source of revenue, but the statute and regulations \* \* \* in express and formal terms required separate and distinct returns thereof, and we think it clear that failure to make a separate return of excess profits tax is none the less a failure to make the return contemplated by the statute because of the mere fact that the computations on the excess profits return are to be carried onto Form 1040; the use of that form also is necessary to a complete report. By section 213 the Commissioner was undoubtedly given authority, with the approval of the Secretary of the Treasury, to require both returns. \* \* \* We think the Commissioner justified in holding that, while the accountant was responsible for the correctness of the figures, plaintiff was responsible for the source of the same and sufficient details to insure a complete understanding of the business, and that failure to take such precaution to 'discover the omission of the principal item of income' does not 'constitute reasonable cause for failure to file an excess profits tax return, which was also due to the omission of the income in question from [plaintiff's] income tax return.' The penalty, while drastic, was intended to insure payment of public revenue. No question of its reasonableness is involved."—The Corporation Trust Company.]



Perpetual Check List  
Supplementary Rulings Reprinted from the Internal Revenue Bulletins.

The Supplementary Rulings are printed on the pages immediately preceding.

**The Foreword to the Supplementary Rulings should be read.**

**Key.**—The word “none,” in the column headed “Last Ruling,” signifies in each case that there are no special rulings bearing on the particular Article of Regulations 45 (1918 Act) or of Regulations 62 (1921 Act).

The numeral, in each case, shows *how many* serially numbered special rulings bearing on the particular Article have been reproduced and indicates *the last* serial number of the group. These serial numbers appear in bold face type at the *end* of the special rulings themselves, within the Supplement.

**Caution.**—To the extent of the imposition of the excess-profits tax for 1921, the 1918 and 1921 laws are identical, except that domestic corporations entitled to the benefits of Section 262 of the 1921 Act (§1083) are grouped with foreign corporations for the purposes of the 1921 excess-profits tax. To much the same extent, with like qualifications, the provisions of Regulations 62 (1921 Act) are essentially identical (there are frequent verbal changes) to the provisions of Regulations 45 (1918 Act). The numbering of the Articles of Regulations 62 (1921 Act) is the same as that of the respective corresponding Articles of Regulations 45 (1918 Act), except as noted below. It follows then, that, except as noted below, for the purposes of the Supplementary Bulletin Rulings, the Article reference number is the same under either Act.

Reg. 62 (1921 Act)	Reg. 45 (1918 Act)
No corresponding Article.....	to Article 712
Article 712 is the same as, therefore refer to, Article	713
“ 713 “ “ “ “ “ “ “ “ “ “	714
“ 714 “ “ “ “ “ “ “ “ “ “	715
“ 715 “ “ “ “ “ “ “ “ “ “	716
No corresponding Article.....	to Article 717
Article 716 is the same as, therefore refer to, Article	719
“ 717 “ “ “ “ “ “ “ “ “ “	718
“ 718 “ “ “ “ “ “ “ “ “ “	720
No corresponding Article.....	to Article 869
Article 869 is the same as, therefore refer to, Article	870
“ 870 “ “ “ “ “ “ “ “ “ “	871

Otherwise

Art. of Reg. 62 is same as, therefore refer to, same numbered Art. of Reg. 45  
(The list is always up-to-date.)

Law Section	Article Number	Last Ruling	Law Section	Article Number	Last Ruling
300.....	701.....	None	302.....	732.....	1
301.....	711.....	1	".....	733.....	None
".....	712.....	None	303.....	741.....	2
".....	713.....	None	".....	742.....	None
".....	714.....	11	".....	743.....	None
".....	715.....	2	304.....	751.....	None
".....	716.....	None	".....	752.....	1
".....	717.....	None	".....	753.....	None
".....	718.....	None	305.....	761.....	None
".....	719.....	1	310.....	771.....	1
".....	720.....	None	311.....	781.....	3
302.....	731.....	1	".....	782.....	None

**Insert immediately preceding blue page 401.**

(Over.)

Law Section	Article Number	Last Ruling	Law Section	Article Number	Last Ruling
311	783	1	326	854	2
"	784	None	"	855	1
"	785	None	"	856	None
312	791	4	"	857	7
320	801	1	"	858	10
"	802	1	"	859	2
325	811	2	"	860	1
"	812	3	"	861	None
"	813	10	"	862	4
"	814	None	"	863	None
"	815	9	"	864	None
"	816	1	"	865	None
"	817	1	"	866	None
"	818	3	"	867	None
326	831	43	"	868	None
"	832	None	"	869	1
"	833	5	"	870	1
"	834	1	"	871	1
"	835	4	327	901	30
"	836	18	328	911	2
"	837	6	"	912	3
"	838	10	"	913	1
"	839	4	"	914	2
"	840	10	330	931	4
"	841	5	"	932	1
"	842	None	"	933	7
"	843	2	"	934	None
"	844	2	331	941	18
"	845	10	335	951	None
"	845A	(See 845)	"	952	1
"	846	4	"	953	None
"	847	None	"	954	None
"	848	None	"	955	None
"	849	None	336	961	None
"	850	2	"	962	None
"	851	7	337	971	2
"	852	1	"	972	None
"	853	1	338	981	None

Every Article of Regulations 45 (1918 Act) and of Regulations 62 (1921 Act) bearing specifically on the war-profits and excess-profits tax is listed in the foregoing table. The first Article is 701.

Missing Article numbers such as 702 to 710 have not yet been used.

*The last Bulletin from which rulings have been reproduced hereinbefore and as listed above is*

**VOLUME II (1923), No. 25.**

*Later Bulletins, since issued (if any), contain no rulings bearing on the 1918 or 1921 excess-profits tax laws.*

**Insert this page to face blue page 401.**



Law Section 326.—Invested Capital (1918 Act—¶555, ante): (1921 Act—¶1035, post).

Article 852.—Percentage of Inadmissible Assets (Reg. 45—¶805, ante): (Reg. 62—¶1221, post).

1-19-125: O. D. 86.

Since the income derived from Porto Rico bonds is not subject to tax, the bonds are inadmissible assets and can not, therefore, be included in invested capital.

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**ADMISSIONS AND DUES TAXES.—RUNNING TABLE OF CONTENTS.****Rulings, Regulations, Opinions and Decisions**

under the

**Admissions and Dues Tax Law Provisions of the Revenue Act of 1921.****Giving Treasury Decision Number or other Designation, Date of Issue, and General Subject Content.**

T. D.	Date	Subject	Paragraph
<b>Law Provisions.....</b>			<b>6500</b>
<b>Reg. 43 Pt. 1.</b>	Feb. 15, 1922	Admissions regulations as amended to January 1, 1923. (Fully indexed on the blue sheets following.)... Page	1319
<b>Reg. 43 Pt. 2.</b>	Apr. 13, "	Dues regulations as amended to January 1, 1923. (Fully indexed on the blue sheets following.).....	6513

The matters listed above are indexed.

3431	Jan. 22, 1923	Admissions: Skating rinks: Court decision, 1918 Act..	6837
3439	Feb. 12, "	Dues: Arts 9, 10, 11, and 12, Reg. 43, Part 2, amended..	6841
3485	June 1, "	Admissions and dues: Art. 41, Reg. 43, Part 1, and Art. 13, Reg. 43, Part 2, amended.....	6882
3504	Aug. 4, "	Admissions: Art. 37, Reg. 43-1 amended to extend time for registry.....	6883

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Special	Apr. 13, "	Drafts covering bunker coal supplied in this country to foreign steamship company.....	4009
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Stamp Tax Law.

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3446	Mar. 1, 1923	Art. 13, Reg. 40, amended.—Sales and transfers of stock not subject to tax.....	4034
3466	Apr. 13, 1923	Art. 5(g), Reg. 40, amended.—Original stock issues not subject to tax.....	4040
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Decision	Aug. 1, 1923	West Virginia Pulp & Paper Company vs. Bowers.—Issue of four \$25 shares in exchange for each outstanding \$100 share.....	4062

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Law Section	Article Number	Last Ruling	Law Section	Article Number	Last Ruling
311.....	783.....	1	326.....	854.....	2
"	784.....	None	"	855.....	1
"	785.....	None	"	856.....	None
312.....	791.....	4	"	857.....	7
320.....	801.....	1	"	858.....	10
"	802.....	1	"	859.....	2
325.....	811.....	2	"	860.....	1
"	812.....	3	"	861.....	None
"	813.....	10	"	862.....	4
"	814.....	None	"	863.....	None
"	815.....	9	"	864.....	None
"	816.....	1	"	865.....	None
"	817.....	1	"	866.....	None
"	818.....	3	"	867.....	None
326.....	831.....	43	"	868.....	None
"	832.....	None	"	869.....	1
"	833.....	5	"	870.....	1
"	834.....	1	"	871.....	1
"	835.....	4	327.....	901.....	30
"	836.....	18	328.....	911.....	2
"	837.....	6	"	912.....	3
"	838.....	10	"	913.....	1
"	839.....	4	"	914.....	2
"	840.....	10	330.....	931.....	4
"	841.....	5	"	932.....	1
"	842.....	None	"	933.....	7
"	843.....	2	"	934.....	None
"	844.....	1	331.....	941.....	18
"	845.....	10	335.....	951.....	None
"	845A.....	(See 845)	"	952.....	1
"	846.....	4	"	953.....	None
"	847.....	None	"	954.....	None
"	848.....	None	"	955.....	None
"	849.....	None	336.....	961.....	None
"	850.....	2	"	962.....	None
"	851.....	7	337.....	971.....	2
"	852.....	1	"	972.....	None
"	853.....	1	338.....	981.....	None

Every Article of Regulations 45 (1918 Act) and of Regulations 62 (1921 Act) bearing specifically on the war-profits and excess-profits tax is listed in the foregoing table. The first Article is 701.

Missing Article numbers such as 702 to 710 have not yet been used.

*The last Bulletin from which rulings have been reproduced hereinbefore and as listed above is*

VOLUME II (1923), No. 23.

*Later Bulletins, since issued (if any), contain no rulings bearing on the 1918 or 1921 excess-profits tax laws.*

Insert this page to face blue page 401.



**Law Section 326.—Invested Capital (1918 Act—¶555, ante): (1921 Act—¶1035, post).**

**Article 844.—Surplus and Undivided Profits. Reserve for Depreciation or depletion (Reg. 45—¶778, ante): (Reg. 62—¶1210, post).**

7-19-308: T. B. M. 41.

The claim of the X Company for the inclusion in its invested capital for the year 1917 of the amount of 6x dollars, representing appreciation in the value of its property, which appreciation had been taken up on its books in 1914 and returned as taxable income for that year, should be denied for the reason that such tax was erroneously assessed and collected. The taxpayer is entitled to a claim for refund.

Reference is made to the claim of the X Company for the inclusion in its invested capital for the year 1917 of an amount of x dollars representing appreciation in the value of a certain part of its property which was taken up on the books in 1914 and returned as a part of its taxable net income for that year, in accordance with article 107 of Regulations 33, which reads as follows:

**Art. 107.** It will be noted from these definitions that the gross income embraces not only the operating revenues but also income, gains, or profits from all other sources, such as rentals, royalties, interest and dividends from stock owned in other corporations, and appreciation in values of assets if taken up on the books of account as gain, also profits made from the sale of assets, investments, etc.

This item was brought to the attention of the Bureau during 1918 and was disallowed in the computation of invested capital for the year 1917. An appeal was made to the Advisory Tax Board, but no evidence has been found that would warrant a change in the original decision of this office.

Regulations 33, from which article 107 is quoted above, were issued in January, 1914, and in March, 1915, the question of the taxability of appreciation of property when taken up on the books of a taxpayer was decided adversely to the Government by the United States Circuit Court of Appeals in the case of the Baldwin Locomotive Works v. McCoach, Collector (221 Fed., 59). This decision was embodied in Treasury Decision 2185, issued April, 1915, which held that an "increase in the valuation of assets on the books of the corporation is not income received during the year, where there is no addition to the plant and all that was done was to revalue the property." It appears, therefore, that the return for 1914 was made in accordance with the regulations of the department, but that shortly after the filing of the return the court decision above mentioned made it necessary for the Treasury Department to rescind the provisions of article 107, of Regulations 33, in so far as they related to the taxation of unrealized appreciation. Between April 1, 1915, and the date upon which the tax for 1914 became due and payable a claim might have been filed for abatement of the proportion of the tax represented by the item of appreciation, and since the date of the payment of the tax the company was entitled to file a claim for refund. This right continues for a period of five years from date upon which the return was due.

The computation of invested capital for the year 1917 is to be determined in accordance with the provisions of the Act of October 3, 1917, and Regulations No. 41, issued thereunder. In article 42 of these Regulations it is provided, *inter alia*, that—

If value appreciation of a kind not subject to income tax (other than that allowed under article 55) has been taken up on the accounts, a deduction must be made in respect of such appreciation so taken up.

As shown above, the appreciation written up on the books in 1914 was not properly subject to income tax. The exception to this rule as found in article 55 referred to in the quotation above reads as follows:

**Tangible property paid in for stock or shares prior to January 1, 1914, must be valued**

at either (a) the actual cash value of such property on January 1, 1914, or (b) the par value of the stock or shares specifically issued therefor, whichever is lower.

This regulation is based upon the statutory provision defining invested capital, which is found in section 207 (a) (2) of the Act of October 3, 1917:

The actual cash value of tangible property paid in other than cash, for stock or shares in such corporation or partnership, at the time of such payment (but in case such tangible property was paid in prior to January 1, 1914, the actual cash value of such property as of January 1, 1914, but in no case to exceed the par value of the original stock or shares specifically issued therefor).

This provision of the law does not allow for any general appreciation of property as at January 1, 1914, and the inclusion of appreciation in invested capital is limited in effect to cases where capital stock has been issued specifically in payment for tangible assets in an amount which at par exceeded the actual cash value of the property at the date of the transaction, but where between such date and January 1, 1914, the property had appreciated in value. In such a case appreciation in an amount not in excess of the difference between the actual cash value of such property at the date of its acquisition and the par value of the stock issued specifically for the property may be included in invested capital. The case does not come within this exception.

The claim for inclusion in invested capital of a dollars representing appreciation in value of property can not be allowed.



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## TAX ON ADMISSIONS AND DUES REGULATIONS.

(T. D. 3485.)

**6882** Time for filing returns and payment of taxes.—The sixth sentence  
 6572 of Article 41, Regulations 43, (Part 1); the fifth sentence of Article  
 6826 13, Regulations 43, (Part 2); the fourth sentence of Article 36, Regulations 47; the sixth sentence of Article 32, Regulations 48; the first sentence of Article 20, Regulations 52; and the second sentence of Article 35, Regulations 57, are hereby amended by inserting a comma at the end thereof, and adding the following: “except that when the last day of the month in which a return and payment are due falls on Sunday or a legal holiday, the return may be filed and payment made to the Collector of Internal Revenue or Deputy Collector on the next secular or business day.” (T. D. 3485, signed by Commissioner D. H. Blair, and dated June 1, 1923.)

(T. D. 3504.)

**6883** Time for registry under the provisions of Article 37, Regulations 43,  
 6817 Part 1, and Article 26 of Regulations 52, extended.—The first sentence of Article 37, Regulations 43, Part 1, (Revised January, 1922) previously amended by Treasury Decision 3394, is hereby further amended to read as follows:

“Application for and certificate of registry.—Every individual, corporation, partnership, or association (1) required by the provisions of the Act to collect any tax on admissions (see Art. 35) or (2) being the owner or lessee of any place which is ordinarily or at times leased to other persons who impose charges for admissions to it (see Art. 42) or (3) required to pay any tax on charges in excess of established price (see Art. 36) shall annually, on or before the *last*\* day of July, or if that day fall on a Sunday or legal holiday, then on the next secular or business day, or within ten days after commencing business, make an application for registry, by filling out Form 752 (Revised), with all information there called for, and duly execute it under oath.” (T. D. 3504, in part, signed by Acting Commissioner C. R. Nash, and dated August 4, 1923.)

\*Changes indicated by italics; application for registry was due, heretofore, on first day of July.—The Corporation Trust Company.





## STAMP TAX REGULATIONS.

**4062** The issue of four \$25 shares in exchange for each outstanding  
**3561** \$100 share (otherwise of the same kind) and the subsequent issue  
 of a share of no par value stock in exchange for each \$25 share, all  
 pursuant to amendments of the issuing corporation's charter increasing  
 the number of shares but not the amount of its capital, held not subject to  
 original issue tax.—[Comment: In West Virginia Pulp & Paper Company  
 vs. Bowers, Collector (U. S. District Court—New York, Southern District,  
 August 1, 1923), the plaintiff sought to recover stamp taxes paid under  
 protest on that which the Collector termed original issues of stock on reor-  
 ganization, and thereupon taxed as such pursuant to the provisions of Article  
 4 (h), Regulations 40 [Par. 3561], and which consisted of the exchange of  
 4 shares of new \$25 par value common stock for each share of outstanding  
 \$100 par value common stock, otherwise of the same kind, in accordance  
 with an amendment of the plaintiff's charter increasing the number of shares  
 from 200,000 to 800,000 without change in the amount of its capital which  
 remained \$20,000,000, and the subsequent exchange of one share of no par  
 value stock for each share of \$25 par value stock pursuant to further amend-  
 ment of the corporation's charter.—The Corporation Trust Company.]

*Memorandum Opinion.*—*Knox, J.:* In a case such as this there is little  
 use for a court of first instance to enter upon a discussion of its views as to the  
 interpretation to be placed upon a particular taxing statute. Any decision  
 of mine will be but a conduit through which a more authoritative ruling will  
 be had, and for such reason I forbear to elaborate upon my conclusions.  
 It is enough to say that in my judgment the acts of plaintiff giving rise to the  
 assessment of the tax in question are not within the purview of the statute  
 upon which defendant relies. What plaintiff did, in my opinion, is not to be  
 regarded as an original issuance of stock, either upon organization or reorgani-  
 zation. No essential change in the capital with which plaintiff does business  
 has taken place, and the rights of its stockholders have been neither increased  
 nor lessened. They continue to hold their respective portions of the original  
 issue of stock save that such portions are now evidenced by an increased  
 number of pieces of paper, and these they may have without their corpora-  
 tion being subjected to the tax assessed against it. Defendant's motion for  
 judgment of dismissal is denied and unless defendant desires to litigate the  
 allegations of fact set up in the complaint there is no reason why plaintiff  
 should not have judgment for the sum sued for.





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3319	Apr. 5, 1922	Title Guarantee and Trust Co. (Teets) vs. Edwards. U. S. District Court Decision. Bequest or devise in lieu of dower.....	262
3383	Aug. 9, 1922	Department Circular 225 extended and made applicable to receipt of Treasury Notes for Estate Taxes.....	388
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Special	June 24, 1920	Tax payment under the 1918 Act may be enforced any time after expiration of the one year period.....	312
Special	June 26, 1920	Transfer of stock: lien on stock and release of lien.....	393
Special	Aug. 21, 1920	U. S. bonds owned by nonresident alien decedent.....	308
Circ. 225	Jan. 31, 1921	Liberty bonds and Victory notes in payment of tax.....	358
Special	Sept. 11, 1922	No certificate releasing lien (waiver) required before transfer of stock of a foreign corporation standing in the name of a nonresident decedent.....	396
<hr/>			
Decision	Feb. 28, 1921	U. S. vs. Field. U. S. Supreme Court decision, 1916 Act as amended. Property passing under general power of appointment.....	403
Decision	Apr., 1921	Smietanka vs. Ullman (See T. D. 3227 above.)	
Decision	May 16, 1921	N. Y. Trust Company vs. Eisner. United States Supreme Court decision, 1916 Act. New York transfer taxes, and other inheritance, succession and legacy taxes are not deductible in the determination of net estate subject to Federal estate tax.....	397
Decision	Mar. 21, 1922	Nichols vs. Gaston. U. S. Circuit Court of Appeals decision, 1918 Act. The tax being due and payable one year after decedent's death, injunctive relief against its collection by distraint within the 180 day period thereafter will not be granted.....	317
Decision	Apr. 5, 1922	Title Guarantee and Trust Co. (Teets) vs. Edwards (See T. D. 3319 above.)	

## ESTATE TAX.—RUNNING TABLE OF CONTENTS.—Continued.

## Rulings, Regulations, Opinions and Decisions

under the

## Estate Tax Laws.

Giving Treasury Decision Number or other Designation, General Subject Content, Date of Issue, and Paragraph Reference.

T. Dec.	Date	Subject	Paragraph
Decision	Apr. 10, 1922	Greiner vs. Lewellyn, U. S. Supreme Court. Value of State and municipal bonds to be included in value of gross estate.....	423
Decisions	May 1, 1922	(1) Shwab vs. Doyle.....	425
		(2) Union Trust Co. vs. Wardell.....	444
		(3) Levy vs. Wardell.....	463
		(4) Knox vs. McElligott.....	477
		(1), (2), (3), and (4). The text of the 1916 Act is not to be construed as applying to transfers in contemplation of death, etc., completed before the passage of the Act. (U. S. Supreme Court.)	
Decision	May 16, 1922	Page vs. Polk. U. S. Circuit Court of Appeals decision, 1918 Act.—The tax being due and payable one year after decedent's death, injunctive relief against its collection by distraint within the 180 day period thereafter, will not be granted.....	345
Decision	June 20, 1922	Slocum et al., executors (Sage estate) vs. Edwards.—U. S. District Court Decision, 1918 Act.—Deductible amount of charitable bequests out of residual estate out of which State succession and Federal estate taxes are paid.....	298

The matters listed above are indexed and forward references thereto are embodied in Regulations 63.

The regulations, rulings, etc., listed below, are those issued during 1923.

Decision	Jan. 8, 1923	Slocum et al., executors (Sage Estate); Edwards vs.—U. S. Circuit Court of Appeals affirms District Court decision at June 20, 1922 above.....	488
3487	June 6, 1923	Art. 21, Reg. 63 (and Art. 25, Reg. 37, 1918 Act) amended—Reservation of Powers.....	E515
Decision	July 3, 1923	Miles vs. Curley, et al.—Maryland collateral inheritance tax was deductible by the estate (1916-1917 Acts).....	E516
3513	Sept. 7, 1923	Receipt of Liberty bonds, Treasury bonds and Treasury notes in payment of estate taxes.....	E532
3514	Sept. 7, 1923	T. D. designation for Miles vs. Curley court decision, ¶E516 above.	

Insert this page immediately before the blue Estate Tax index.



**UNINDEXED SUPPLEMENTARY ESTATE TAX REGULATIONS, ETC.**

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**E535** 3. For the calculation of accrued interest on the current coupons of bonds and notes tendered in payment of estate or inheritance taxes under this circular, the method outlined in Exhibit B [¶383] to Department Circular No. 225, dated January 31, 1921, should be followed. Interest tables at the various rates borne by the various issues, or for other or future issues, may be obtained from the Treasury Department, Division of Loans and Currency, Washington, upon request. (Second Supplement to Department Circular No. 225 appended to T. D. 3513, ¶E532, signed by S. P. Gilbert, Jr., Acting Secretary of the Treasury, and dated July 31, 1923.)

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Base 1. The line of the ... (The text is extremely faint and largely illegible due to the quality of the scan. It appears to be a descriptive paragraph about a survey or land area.)

Base 2. ... (This section continues the descriptive text, mentioning various measurements and survey details. The text is too faint to transcribe accurately.)

Base 3. ... (This section provides further details about the survey, possibly including a list of points or a summary of findings. The text is illegible.)

Base 4. ... (This section likely contains a concluding statement or a reference to other documents. The text is illegible.)



The Foreword to the Supplementary Rulings should be read.

The numeral, in each case, shows *how many* serially numbered special rulings bearing on the particular Article have been reproduced and indicates *the last* serial number of the group. These serial numbers appear in bold face type at the *end* of the special rulings themselves, within the Supplement.

Reg. 62 (1921 Act)      50 Reg. 45 (1918 Act)

Article 712 is the same as, therefore refer to, Article 713

“ 715 “ “ “ “ “ “ “ “ 716

Article 716 is the same as, therefore refer to, Article 719

to corresponding Article.....to Article 869

" 870 " " . . . " 871

Art. of Reg. 62 is same as, therefore refer to, same numbered Art. of Reg. 45

Law Section	Article Number	Last Ruling	Law Section	Article Number	Last Ruling
300.....	701.....	None	302.....	732.....	1
301.....	711.....	1	".....	733.....	None
".....	712.....	None	303.....	741.....	2
".....	713.....	None	".....	742.....	None
".....	714.....	11	".....	743.....	None
".....	715.....	2	304.....	751.....	None
".....	716.....	None	".....	752.....	1
".....	717.....	None	".....	753.....	None
".....	718.....	None	305.....	761.....	None
".....	719.....	1	310.....	771.....	1
".....	720.....	None	311.....	781.....	3
302.....	731.....	1	".....	782.....	None

(Over.)

Law Section	Article Number	Last Ruling
311	783	1
"	784	None
"	785	None
312	791	4
320	801	1
"	802	1
325	811	2
"	812	3
"	813	10
"	814	None
"	815	9
"	816	1
"	817	1
"	818	3
326	831	43
"	832	None
"	833	5
"	834	1
"	835	4
"	836	18
"	837	6
"	838	10
"	839	4
"	840	10
"	841	5
"	842	None
"	843	2
"	844	1
"	845	10
"	845A	(See 845)
"	846	4
"	847	None
"	848	None
"	849	None
"	850	2
"	851	6
"	852	1
"	853	1

Law Section	Article Number	Last Ruling
326	854	2
"	855	1
"	856	None
"	857	7
"	858	10
"	859	2
"	860	1
"	861	None
"	862	4
"	863	None
"	864	None
"	865	None
"	866	None
"	867	None
"	868	None
"	869	1
"	870	None
"	871	1
327	901	30
328	911	2
"	912	3
"	913	1
"	914	2
330	931	4
"	932	1
"	933	7
"	934	None
331	941	18
335	951	None
"	952	1
"	953	None
"	954	None
"	955	None
336	961	None
"	962	None
337	971	2
"	972	None
338	981	None

Every Article of Regulations 45 (1918 Act) and of Regulations 62 (1921 Act) bearing specifically on the war-profits and excess-profits tax is listed in the foregoing table. The first Article is 701.

**Missing Article numbers** such as 702 to 710 have not yet been used.

*The last Bulletin from which rulings have been reproduced hereinbefore and as listed above is*

**VOLUME II (1923), No. 22.**

*Later Bulletins, since issued (if any), contain no rulings bearing on the 1918 or 1921 excess-profits tax laws.*

**Insert this page to face blue page 401.**



assumes that such value has been determined in accordance with the law and regulations and to the satisfaction of the Unit.

Article 163 of Regulations 45, issued under the Revenue Act of 1918, is equally applicable under the Revenue Act of 1917. This article provides in part:

If, however, an intangible asset acquired through capital outlay is known from experience to be of value in the business for only a limited period, the length of which can be estimated from experience with reasonable certainty, such intangible asset may be the subject of a depreciation allowance, \* \* \*.

In the determination of the depreciation allowance which may be claimed in the 1917 return of the taxpayer, two factors must be known and are apparent in the record, to wit: the cost of the asset, and its life, as determined by the period for which the right under which the company operated in 1917, was to run.

These factors as shown by the record are: cost of asset,  $x$  dollars; and life of asset, 23.5 months.

It is the opinion of the Committee, therefore, that the depreciation allowance to which the taxpayer is entitled for the calendar year 1917 is an amount which bears the same ratio to  $x$  dollars as twelve months (the taxable year) bears to 23.5 months (the total period or life of the asset).

In line with this opinion there appears to be no question as to the measure of value which may be assigned to the asset (patent right) for purposes of invested capital as of January 1, 1917, which necessarily must be  $x$  dollars minus depreciation for one and one-half months (November —, to December 31, 1916), or an amount not in excess of 20 per cent of the total shares of stock outstanding on March 3, 1917, measured by their value as at date or dates of issue, whichever is lower.

It is recommended, therefore, in the appeal of the M Company that there be allowed as a deduction from gross income in the company's 1917 return a depreciation of patent rights in an amount which bears the same ratio to the established cost of the patent rights,  $x$  dollars, as 12 months (the taxable year) bears to 23.5 months (the total period for which the patent rights are to run); and that the valuation assigned to such asset as of January 1, 1917, for invested capital purposes be the cost of the asset,  $x$  dollars minus depreciation for one and one-half months, or an amount not in excess of 20 per cent of the total shares of stock outstanding on March 3, 1917, measured by their value as at date or dates of issue, whichever is lower. (See art. 58, Reg. 41.)





## ESTATE TAX.—RUNNING TABLE OF CONTENTS.

Rulings, Regulations, Opinions and Decisions  
under the  
Estate Tax Laws.

Giving Treasury Decision Number or other Designation, General Subject Content,  
Date of Issue, and Paragraph Reference.

T. D.	Date	Subject	Paragraph
1921 Law Provisions			1
Reg. 63	July 27, 1922	Comprehensive regulations, fully indexed (blue index immediately following), and with complete table of contents beginning on page 35.	
2372	Sept. 25, 1916	Notice by others than qualified executor or administrator.....	311
2449	Feb. 13, 1917	Value of U. S. bonds may not be excluded.....	307
2529	Oct. 4, 1917	Household effects.....	256
2705	Apr. 23, 1918	U. S. bonds in payment of tax.....	353
3138	Mar. 3, 1921	Community property in the eight states having community property laws.....	264
3144	Mar. 3, 1921	Receipt of Liberty bonds or Victory notes in payment of tax.....	387
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Decision	Apr. 5, 1922	Title Guarantee and Trust Co. (Teets) vs. Edwards (See T. D. 3319 above.)	

## ESTATE TAX.—RUNNING TABLE OF CONTENTS.—Continued.

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Estate Tax Laws.

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		(2) Union Trust Co. vs. Wardell.....	444
		(3) Levy vs. Wardell.....	463
		(4) Knox vs. McElligott.....	477
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Decision	May 16, 1922	Page vs. Polk. U. S. Circuit Court of Appeals decision, 1918 Act.—The tax being due and payable one year after decedent's death, injunctive relief against its collection by distraint within the 180 day period thereafter, will not be granted.....	345
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3487	June 6, 1923	Art. 21, Reg. 63 (and Art. 25, Reg. 37, 1918 Act) amended —Reservation of Powers.....	E515
Decision	July 3, 1923	Miles vs. Curley, et al.—Maryland collateral inheritance tax was deductible by the estate (1916-1917 Acts)..<	E516

Insert this page immediately before the blue Estate Tax index.



## UNINDEXED SUPPLEMENTARY ESTATE TAX REGULATIONS, ETC.

day of April, 1922, for the plaintiffs, and against the defendant, for the sum of \$3,710.25, and \$26.05 costs.

**E521** There is but one question in this case, and that is, does the Maryland collateral inheritance tax attach to an estate before distribution? If so, the plaintiffs are entitled to recover the amount above named.

"*Lederer vs. Northern Trust Co.*, 262 Fed. 52; 253 U. S. 487."

**E522** If, on the other hand, the Maryland tax is a legacy tax, and not an estate tax, the sum in controversy was properly collected.

"*New York Trust Co. vs. Eisner*, 256 U. S. 345 [¶397 herein]".

**E523** The decision by the highest court of Maryland, directly deciding this question, and construing the statute imposing such collateral inheritance tax, would be binding upon this court. Is there any such decision?

**E524** In discussing this question, the learned district judge, in his opinion overruling the demurrer to the declaration herein says:

"In the case at bar, each side has argued that the Court of Appeals of this State has interpreted the act in the sense for which it contends, and each quotes language which, if standing alone, might sustain its position. That each is able to do so is perhaps the best proof that the attention of that high court never had been drawn to the precise point now at issue, in such sense, at least, as to call for its definite determination."

**E525** We have examined the cases decided by the Court of Appeals of Maryland, and referred to in the briefs of counsel, and have reached the conclusion that no decision upon this point has been really made.

**E526** The Pennsylvania statute upon the subject of collateral inheritance tax, is believed to be the first that was passed by any state in America. This statute was enacted in 1826.

**E527** In 1884, the legislature of the State of Maryland, in substance and effect adopted the Pennsylvania statute.

**E528** In the case of *Jackson vs. Myers*, 257 Pa. 104, the Supreme Court of Pennsylvania decided that the collateral inheritance tax of Pennsylvania is not levied upon the inheritance or legacy, but upon the estate of the decedent, holding that what passes to the legatee is simply the portion of the estate remaining, after the State has been satisfied by receiving the tax.

**E529** An examination of other cases in that State shows, that this case only follows the previous holdings on this subject.

**E530** The question presented herein, for decision, was directly presented to the Circuit Court of Appeals of the third circuit, in the case of *Lederer vs. Northern Trust Company*, *supra*, and that case held, that under the Pennsylvania statute, and the decisions of the court of last resort in the State of Pennsylvania, such tax was an estate tax, and not a legacy tax, and that the plaintiff therein should recover from the collector, the amount so paid under protest.

**E531** Upon the authority of that case, and under all the circumstances and conditions surrounding this case, we hold that the proper construction of the collateral inheritance statute of Maryland, makes such tax an estate tax, and not a legacy tax, and, therefore, the judgment below, is

*Affirmed.*





that his son had control of the business until 1913; further, that the company operated consistently at a loss up to 1913, when it was placed in the hands of a receiver, at which time it was rehabilitated without corporate reorganization through the transfer of capital stock to creditors. It is shown that creditors' claims amounting to  $3\frac{1}{4}\times$  dollars were, as before stated, canceled, and at the same time there was a transfer to said creditors of  $3\times$  dollars par value of the company's capital stock from the members of A's family; also further shares were transferred and sold to obtain financial aid necessary to place the company and its business on a working basis. As a result of such transfers, the control of the corporation since 1913 has been in the hands of B and C, of the O Company. These two individuals, it appears, were the principal creditors of the appellant company at the time receiver was appointed.

It is the claim of the corporation that the amount of debts so canceled constitutes a contribution of new capital invested by the creditors to the extent of their canceled claims.

The view expressed by the Unit in its memorandum of February 16, 1921, is substantially as follows:

Inasmuch as the creditors received stock for the cancellation of their claims, it was the opinion of the representatives of the Bureau that the amount involved did not constitute paid-in surplus within the meaning of the law.

Upon consideration of the foregoing, it appears to the Committee that at a time just prior to the receivership the appellant company's invested capital was  $5\times$  dollars, provided that the par value of the total capitalization of the company was fully paid in at the time of organization, and this is true despite the fact that at a time just prior to the receivership the company showed a large operating deficit. In this connection attention is called to the fact that the Bureau has consistently held that the original amount of capital paid in for stock subscriptions shall never be reduced for purposes of computing invested capital by reason of an operating deficit. Conceded, then, that the invested capital at a time just prior to the receivership in 1913 was  $5\times$  dollars, what effect, if any, had the stock transactions between stockholders upon invested capital? The Committee can see no change in invested capital resulting thereby. The transfer of stock between the several stockholders of the corporation or between stockholders and persons who have not prior to such action been stockholders, whether for a valuable consideration in excess of or less than the par value or market value of the corporate stock, or for no consideration whatsoever, can, in the opinion of the Committee, have no effect upon the measure to be assigned to the original paid-in capital for the purpose of computing invested capital.

It is pointed out in the instant case that the principal creditors of the corporation at the time of the receivership received by transfer from the majority stockholders  $3\times$  dollars par value of the capital stock. It does not appear whether a consideration of any description entered into this transaction. However, the Committee can see no possible effect which such transaction could have upon the original paid-in capital for the purpose of determining invested capital.

With respect to the cancellation of the claims of creditors who were themselves stockholders and assumed control by reason of the transfer aforesaid, it is the opinion of the Committee that such action clearly resulted in an additional contribution to capital which assumed the character of paid-in surplus. The situation seems to be that these stockholders made numerous advances either in money or money's worth to the corporation which gave rise to an existing liability constituting a charge against the corporate assets.

By the cancellation of such claims a condition arose whereby the corporate liabilities were correspondingly reduced and the assets correspondingly increased.

It is true that this action on the part of said stockholders effected no change in the corporate surplus for the reason that an operating deficit existed. However, the applicable rule in this connection is found in article 860 of Regulations 45, which provides in part that:

Capital or surplus actually paid in is not required to be reduced because of an impairment of capital in the nature of an operating deficit.

A careful study of the above matters leads the Committee to conclude that the cancellation by stockholders of  $3\frac{1}{4}x$  dollars of claims owing to such stockholders resulted in effect in an additional contribution to the corporation's capital account which assumed for the purposes of invested capital the nature of paid-in surplus; further, that this is true regardless of any transfers of stock as between the stockholders which may or may not have been a consideration moving to the cancellation of said claims.

It follows obviously that the corporation's invested capital is at least the  $5x$  dollars fully paid-up capital as it existed just prior to the receivership, plus the  $3\frac{1}{4}x$  dollars paid-in surplus, which was effected by reason of the cancellation of the stockholding creditors' claims, or a total of  $8\frac{1}{4}x$  dollars. Therefore, it is recommended in the appeal of the M Company that the action of the Income Tax Unit in denying the right to include in the computation of invested capital as paid-in surplus  $3\frac{1}{4}x$  dollars representing claims owed to and canceled by creditor stockholders be reversed, and accordingly that the taxpayer's appeal be sustained.

5

It is pointed out in the instant case that the principal purpose of the corporation at the time of the receivership was to transfer from the majority stockholders the value of the capital stock. It does not appear whether a consideration of such description entered into this transaction. However, the Committee can see no possible effect which such transaction could have upon the original paid-in capital for the purpose of determining invested capital.

With respect to the cancellation of the claims of creditors who themselves stockholders and assumed control by reason of the transfer above said, it is the opinion of the Committee that such action clearly resulted in an additional contribution to capital which assumed the character of paid-in surplus. The situation seems to be that these stockholders were interested in money rather than in the corporation which gave rise to an existing liability constituting a charge against the corporate assets.



The Supplementary Rulings are printed on the pages immediately preceding.

The Foreword to the Supplementary Rulings should be read.

The numeral, in each case, shows *how many* serially numbered special rulings bearing on the particular Article have been reproduced and indicates *the last* serial number of the group. These serial numbers appear in bold face type at the *end* of the special rulings themselves, within the Supplement.

**Caution.**—To the extent of the imposition of the excess-profits tax for 1921, the 1918 and 1921 laws are identical, except that domestic corporations entitled to the benefits of Section 262 of the 1921 Act (§1083) are grouped with foreign corporations for the purposes of the 1921 excess-profits tax. To much the same extent, with like qualifications, the provisions of Regulations 62 (1921 Act) are essentially identical (there are frequent verbal changes) to the provisions of Regulations 45 (1918 Act). The numbering of the Articles of Regulations 62 (1921 Act) is the same as that of the respective corresponding Articles of Regulations 45 (1918 Act), except as noted below. It follows then, that, except as noted below, for the purposes of the Supplementary Bulletin Rulings, the Article reference number is the same under either Act.

Reg. 62 (1921 Act)	Reg. 45 (1918 Act)
No corresponding Article.....	to Article 712
Article 712 is the same as, therefore refer to, Article	713
“ 713 “ “ “ “ “ “ “ “	714
“ 714 “ “ “ “ “ “ “ “	715
“ 715 “ “ “ “ “ “ “ “	716
No corresponding Article.....	to Article 717
Article 716 is the same as, therefore refer to, Article	719
“ 717 “ “ “ “ “ “ “ “	718
“ 718 “ “ “ “ “ “ “ “	720
No corresponding Article.....	to Article 869
Article 869 is the same as, therefore refer to, Article	870
“ 870 “ “ “ “ “ “ “ “	871

Otherwise

Art. of Reg. 62 is same as, therefore refer to, same numbered Art. of Reg. 45  
(The list is always up-to-date.)

Law Section	Article Number	Last Ruling	Law Section	Article Number	Last Ruling
300.....	701.....	None	302.....	732.....	1
301.....	711.....	1	".....	733.....	None
".....	712.....	None	303.....	741.....	2
".....	713.....	None	".....	742.....	None
".....	714.....	11	".....	743.....	None
".....	715.....	2	304.....	751.....	None
".....	716.....	None	".....	752.....	1
".....	717.....	None	".....	753.....	None
".....	718.....	None	305.....	761.....	None
".....	719.....	1	310.....	771.....	1
".....	720.....	None	311.....	781.....	3
302.....	731.....	1	".....	782.....	None

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(Over.)

Law Section	Article Number	Last Ruling
311.....	783.....	1
"	784.....	None
"	785.....	None
312.....	791.....	4
320.....	801.....	1
"	802.....	1
325.....	811.....	2
"	812.....	3
"	813.....	10
"	814.....	None
"	815.....	9
"	816.....	1
"	817.....	1
"	818.....	3
326.....	831.....	43
"	832.....	None
"	833.....	5
"	834.....	1
"	835.....	4
"	836.....	18
"	837.....	5
"	838.....	10
"	839.....	4
"	840.....	10
"	841.....	5
"	842.....	None
"	843.....	2
"	844.....	1
"	845.....	10
"	845A.....	(See 845)
"	846.....	4
"	847.....	None
"	848.....	None
"	849.....	None
"	850.....	2
"	851.....	6
"	852.....	1
"	853.....	1

Law Section	Article Number	Last Ruling
326.....	854.....	2
"	855.....	1
"	856.....	None
"	857.....	7
"	858.....	10
"	859.....	2
"	860.....	1
"	861.....	None
"	862.....	4
"	863.....	None
"	864.....	None
"	865.....	None
"	866.....	None
"	867.....	None
"	868.....	None
"	869.....	1
"	870.....	None
"	871.....	1
327.....	901.....	30
328.....	911.....	2
"	912.....	3
"	913.....	1
"	914.....	2
330.....	931.....	4
"	932.....	1
"	933.....	7
"	934.....	None
331.....	941.....	18
335.....	951.....	None
"	952.....	1
"	953.....	None
"	954.....	None
"	955.....	None
336.....	961.....	None
"	962.....	None
337.....	971.....	2
"	972.....	None
338.....	981.....	None

Every Article of Regulations 45 (1918 Act) and of Regulations 62 (1921 Act) bearing specifically on the war-profits and excess-profits tax is listed in the foregoing table. The first Article is 701.

Missing Article numbers such as 702 to 710 have not yet been used.

*The last Bulletin from which rulings have  
been reproduced hereinbefore and as listed above is*

VOLUME II (1923), No. 16.

*Later Bulletins, since issued (if any), contain no rulings bearing on the  
1918 or 1921 excess-profits tax laws.*

Insert this page to face blue page 401.



## STAMP TAX REGULATIONS.

**4062** The issue of four \$25 shares in exchange for each outstanding  
 3561 \$100 share (otherwise of the same kind) pursuant to an amendment  
 of the issuing corporation's charter increasing the number of shares  
 but not the amount of its capital, held not subject to original issue tax.—  
 [Comment: In *West Virginia Pulp & Paper Company vs. Bowers*, Collector  
 (U. S. District Court—New York, Southern District, August 1, 1923), the  
 plaintiff sought to recover stamp tax paid under protest on that which the  
 Collector termed an original issue of stock on reorganization, and thereupon  
 taxed as such pursuant to the provisions of Article 4 (h), Regulations 40 [Par.  
 3561], and which consisted of the exchange of 4 shares of new \$25 par value  
 common stock for each share of outstanding \$100 par value common stock,  
 otherwise of the same kind, in accordance with an amendment of the plain-  
 tiff's charter increasing the number of shares from 200,000 to 800,000 without  
 change in the amount of its capital which remains \$20,000,000.—The Cor-  
 poration Trust Company.]

*Memorandum Opinion.*—*Knox, J.:* In a case such as this there is little  
 use for a court of first instance to enter upon a discussion of its views as to the  
 interpretation to be placed upon a particular taxing statute. Any decision  
 of mine will be but a conduit through which a more authoritative ruling will  
 be had, and for such reason I forbear to elaborate upon my conclusions.  
 It is enough to say that in my judgment the acts of plaintiff giving rise to the  
 assessment of the tax in question are not within the purview of the statute  
 upon which defendant relies. What plaintiff did, in my opinion, is not to be  
 regarded as an original issuance of stock, either upon organization or reorgan-  
 ization. No essential change in the capital with which plaintiff does business  
 has taken place, and the rights of its stockholders have been neither increased  
 nor lessened. They continue to hold their respective portions of the original  
 issue of stock save that such portions are now evidenced by an increased  
 number of pieces of paper, and these they may have without their corpora-  
 tion being subjected to the tax assessed against it. Defendant's motion for  
 judgment of dismissal is denied and unless defendant desires to litigate the  
 allegations of fact set up in the complaint there is no reason why plaintiff  
 should not have judgment for the sum sued for.

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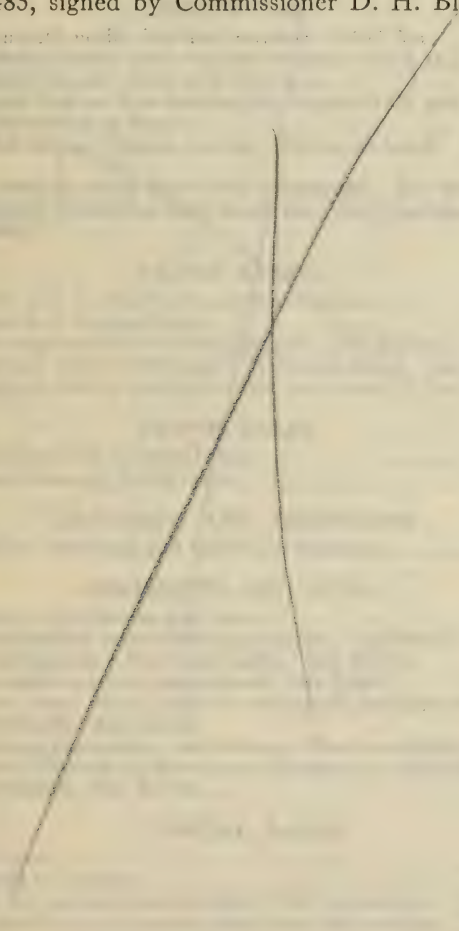


**TAX ON ADMISSIONS AND DUES REGULATIONS.**

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(T. D. 3485.)

**6882** **Time for filing returns and payment of taxes.**—The sixth sentence  
6572 of Article 41, Regulations 43, (Part 1); the fifth sentence of Article  
6826 13, Regulations 43, (Part 2); the fourth sentence of Article 36, Regulations 47; the sixth sentence of Article 32, Regulations 48; the first sentence of Article 20, Regulations 52; and the second sentence of Article 35, Regulations 57, are hereby amended by inserting a comma at the end thereof, and adding the following: "except that when the last day of the month in which a return and payment are due falls on Sunday or a legal holiday, the return may be filed and payment made to the Collector of Internal Revenue or Deputy Collector on the next secular or business day." (T. D. 3485, signed by Commissioner D. H. Blair, and dated June 1, 1923.)







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## STAMP TAX REGULATIONS.

**3546 REGULATIONS 40—1922 EDITION**

[Promulgated July 8, 1922—Also designated as T. D. 3380.]  
(Supplemented.)

Relating to the

**STAMP TAX ON ISSUES, SALES, AND TRANSFERS OF STOCK AND SALES OF  
PRODUCTS FOR FUTURE DELIVERY**

Under

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**3548** Art. 2. Rate of taxation.—(a) All certificates or instruments, of whatever designation, having a par or face value, representing shares of stock, or of profits, or of interest in property or accumulations, issued by any corporation, joint-stock company or association, are subject to tax at the rate of 5 cents on each \$100 of the face value or fraction thereof.

**3549** (b) All certificates of stock, or of profits, or of interest in property or accumulations issued by any corporation, without par or face value, are subject to the tax of 5 cents per share, unless the actual value is in excess of \$100 per share, in which case the tax shall be 5 cents on each \$100 of actual value or fraction thereof, or unless the actual value is less than \$100 per share, in which case the tax shall be 1 cent on each \$20 of actual value or fraction thereof. [See ¶4016 and ¶4019].



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The matters listed above are fully indexed on the blue index following page 400.

For running table of contents of matters relating to the 1921 Excess Profits Tax Law specially, and to other matters issued since the passage of that Act, see  
Excess-Profits Tax Supplementary Page 2, over.

# **EXCESS PROFITS TAX.—RUNNING TABLE OF CONTENTS.**

## **Rulings, Regulations, Opinions and Decisions under the**

### **War-Profits and Excess-Profits Tax Laws.**

Giving Treasury Decision Number or other Designation, General Subject Content,  
Date of Issue, and Paragraph Reference.

T. D.	Date	Subject	Paragraph
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The regulations, rulings, etc., listed immediately below, were issued during 1922.

**1921 Law Provisions..... 1000**

<b>Reg. 6s, Pt. II-B Regulations under 1921 Act (1922 Edition). Promulgated February 15, 1922. Released for publication March 1, 1922.....</b>			
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3367	July 10, 1922	Art. 836, Reg. 62, amended.—Tangible property paid in; value in excess of par value of stock.....	1265
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3389	Aug. 24, "	Arts. 77 and 78, Reg. 41 (1917 Act) amended.—Consolidated returns, 1917.....	1289

The matters listed above are fully indexed on the blue index beginning opposite.

Decision	Jan. 2, 1923	Greenport Basin and Construction Co. vs. U. S., 1917 Act.—Application of the deduction in the computation of the tax.....	1297
3429	" 19, "	T. D. designation for the Greenport Basin and Construction Co. vs. U. S. decision (see Jan. 2, 1923, above) reported at ¶1297.	
Decision	Feb. 5, "	Lincoln Chemical Co. vs. Edwards, 2d. C. C. of A. decision, 1917 Act.—Additions to surplus account: Earned surplus expended in developing and improving a secret process, or used to repay borrowed money so expended.....	1300
3458	Apr. 4, "	(This T. D. reproduces, merely, the decision in Lincoln Chemical Company case, ¶1300 above.)	
Decision	Mar. 14, "	Woods vs. Lewellyn, 1917 Act (tax on individuals).—Commissions on certain renewal insurance premiums	1327
Decision	July 5, "	De Laskie and Thropp Circular Woven Tire Co.: Iredell vs. 3d C. C. of A. decision, 1917 Act. Nominal capital vs. invested capital; patent royalties.....	1328

**Insert this page immediately before the blue Excess-Profits Tax—1921 Act—Index**



as provided by the Section, engaged in a trade or business having a nominal capital. It was not a producer or manufacturer but its entire business was simply to collect and distribute the rental or royalty charged for use of its patents and, as it may, in accordance with said Section, be assessed with "a tax equivalent to eight per centum of the net income of such trade or business" it follows by the terms of the section this shall be "in lieu of the tax imposed by section two hundred and one."

**1332** The Court below having found as a fact—a finding in which we concur—that the trade or business of the Plaintiff had no invested capital, and such being the plain wording of the statute, it follows that an attempt by departmental construction to theoretically swell that nominal capital into a large amount, simply because its business on its nominal capital proved highly remunerative, is at variance with the taxing statute and with the principle that the right to impose taxation must have clear statutory warrant and that doubtful constructions must be resolved in favor of the taxpayer.

*The judgment below is affirmed.*

incidental to the conduct of the plaintiff's business and was used entirely as a fund from which to advance salaries, wages, etc., and to provide office furniture, accommodations and equipment.

10. In compliance with the provisions of the Act of Congress entitled 'An Act to Provide Revenue to Defray War Expenses and other Purposes,' approved October 3, 1917, plaintiff made due returns to the defendant of its annual net income for the twelve (12) months ended December 31, 1917, and paid the income and excess profits taxes due thereunder, in accordance with the provisions of Section 209 of the said Act, whereby the excess profits tax was levied and assessed upon corporations employing no invested capital or not more than a nominal capital. The plaintiff's contention in this respect was disallowed by the Commissioner of Internal Revenue, and after various letters had been exchanged and a hearing had in Washington, the plaintiff was notified by the defendant in August, 1919, that additional income and excess profits taxes for the year 1917 had been assessed against it in the sum of \$16,969.45, which amount had been arrived at upon the basis of a fictitious capital constructed under Section 210 of the said Act and an application of the rates prescribed by Section 201 of the Act for corporations employing capital."





(Over.)

Law Section	Article Number	Last Ruling	Law Section	Article Number	Last Ruling
311.....	783.....	1	326.....	854.....	2
"	784.....	None	"	855.....	1
"	785.....	None	"	856.....	None
312.....	791.....	4	"	857.....	6
320.....	801.....	1	"	858.....	10
"	802.....	1	"	859.....	2
325.....	811.....	2	"	860.....	1
"	812.....	3	"	861.....	None
"	813.....	10	"	862.....	3
"	814.....	None	"	863.....	None
"	815.....	9	"	864.....	None
"	816.....	1	"	865.....	None
"	817.....	1	"	866.....	None
"	818.....	3	"	867.....	None
326.....	831.....	43	"	868.....	None
"	832.....	None	"	869.....	1
"	833.....	5	"	870.....	None
"	834.....	1	"	871.....	1
"	835.....	4	327.....	901.....	30
"	836.....	18	328.....	911.....	2
"	837.....	5	"	912.....	3
"	838.....	10	"	913.....	1
"	839.....	4	"	914.....	2
"	840.....	10	330.....	931.....	4
"	841.....	5	"	932.....	1
"	842.....	None	"	933.....	7
"	843.....	2	"	934.....	None
"	844.....	1	331.....	941.....	18
"	845.....	10	335.....	951.....	None
"	845A.....	(See 845)	"	952.....	1
"	846.....	4	"	953.....	None
"	847.....	None	"	954.....	None
"	848.....	None	"	955.....	None
"	849.....	None	336.....	961.....	None
"	850.....	2	"	962.....	None
"	851.....	6	337.....	971.....	2
"	852.....	1	"	972.....	None
"	853.....	1	338.....	981.....	None

Every Article of Regulations 45 (1918 Act) and of Regulations 62 (1921 Act) bearing specifically on the war-profits and excess-profits tax is listed in the foregoing table. The first Article is 701.

Missing Article numbers such as 702 to 710 have not yet been used.

*The last Bulletin from which rulings have  
been reproduced hereinbefore and as listed above is*

VOLUME II (1923), No. 15.

*Later Bulletins, since issued (if any), contain no rulings bearing on the  
1918 or 1921 excess-profits tax laws.*

Insert this page to face blue page 401.



computation of the increase in invested capital for the war profits credit. It is not considered that the income of A from royalties on patents can be capitalized to determine the invested capital of A for the prewar period.

Summing up, the Committee recommends:

1. That, in the appeal of the M Company, the value of patents acquired by said company at date of organization be placed at  $144\frac{1}{2}x$  dollars and the value of good will, trade-marks, etc., be placed at  $37\frac{1}{5}x$  dollars (these figures being subject to verification by the Unit under the principles of valuation herein stated).

2. That the corporation be allowed to amortize its patents in the taxable year 1918 on basis of one-seventeenth of the value recommended herein.

3. That the preferred stock purchased by the corporation and held as treasury stock be excluded in determining the statutory limitation on intangibles for purposes of invested capital.

4. That the corporation be denied its inventory adjustment at December 31, 1918, because net inventory loss has not been established.

5. That the corporation be allowed the value of patents of A in the computation of prewar invested capital in accordance with provisions of section 330 of the Revenue Act of 1918 and article 934 of Regulations 45.

6. That the corporation be allowed income from royalties on patents owned by A in computing prewar income in accordance with the provisions of section 330 of the Act.

3

...of the interest in the company for the year ending 1910. It was considered that the interest of A. J. ... was for the year ending 1910.



Accrued excess profits tax.....	4,850.00
Net income to April 1, 1919.....	30,000.00
Excess profits tax.....	\$4,850
Proportionate part of specific exemption.....	500
	<u>5,350.00</u>
Subject to income tax at 10 per cent.....	24,650.00
Accrued income tax.....	2,465.00
Accrued profits tax.....	4,850.00
Total accrued income and profits tax.....	<u>7,315.00</u>
Income to Apr. 1, 1919.....	30,000.00
Reduced by taxes to Apr. 1, 1919.....	<u>7,315.00</u>
Amount net income available for dividends.....	22,685.00
Amount of dividend.....	40,000.00
Amount of income available.....	<u>22,685.00</u>
Amount chargeable against surplus.....	17,315.00

The adjustment on account of this amount (\$17,315.00) averaged from April 1, 1919, to the end of the year must be made in Schedule H of Form 1120.

3

30-21-1749: C. D. 982.

In accordance with the principle set out in article 857 of Regulations 45, dividends are deemed to be paid from true earned surplus. In carrying the earnings for a proportionate part of the year to surplus account for the purpose of declaring a dividend, the earnings so carried should represent the earnings of the current year less accrued expenses. Where the true earned surplus of the current year proportioned to the date of dividend payment is not sufficient to cover such payment, the true earnings included in the surplus account as of the beginning of the taxable year will be deemed to cover such payment.

This does not conflict with the principle embodied in article 845 of the regulations. It is in accord with the accounting principle that where accounts are kept on the accrual basis, expenses of a year should be charged against the income of that year. In order, therefore, to apply this principle, taxes of the current year should be charged against the income of that year, and only that proportion of the income of the current year is available for dividends which is in excess of taxes and other proper charges against such income.

4

I('22)-29-416: I. T. 1396.

#### Revenue Act of 1918.

In computing, under the provisions of article 857, the amount of earnings available for the payment of dividends, all income for the taxable year over and above expenses, taxes, and other accrued liabilities of such year, regardless of whether or not any part of such income is exempt from Federal income tax, should be considered.

In making such computation donations previously paid must be deducted.

5

II('23)-3-773: I. T. 1602.

**Revenue Act of 1921.**

In October, 1921, the M Company distributed a cash dividend to its stockholders, such distribution being in excess of the available surplus, undivided profits, and earnings. It was the express purpose of the company when the distribution was made that all or any portion of the amount distributed in excess of the available surplus, undivided profits, and earnings would be chargeable to depletion reserve as a return of capital. The company determines in each year as of September 30 the rates of depletion and depreciation for the current year, and book entries in accordance with such determination are made as of December 31 of each year.

The question is raised whether the charges determined as of September 30, providing for depreciation and depletion for 1921, should be allocated proportionately to each month beginning with January, 1921, and become a charge against the surplus, undivided profits, and earnings available as of the close of each such month, even though the entries for depletion and depreciation were not actually determined and booked until December, 1921, subsequent to the declaration of payment of the distribution above referred to.

It is held, that the net income for the year 1921, determined after providing for depreciation and depletion and also for an accrual of income and excess profits taxes for the year, should be prorated over the year from January 1, 1921, to the date of the payment of the dividend made in October, 1921, in order to determine the amount available for distribution to the stockholders. Any excess of the dividend over the amount of surplus from previous years and of current earnings is a return of capital in a corresponding amount.



**Perpetual Check List**  
**Supplementary Rulings Reprinted from the Internal Revenue Bulletins.**

The Supplementary Rulings are printed on the pages immediately preceding.

**The Foreword to the Supplementary Rulings should be read.**

**Key.**—The word “none,” in the column headed “Last Ruling,” signifies in each case that there are no special rulings bearing on the particular Article of Regulations 45 (1918 Act) or of Regulations 62 (1921 Act).

The numeral, in each case, shows *how many* serially numbered special rulings bearing on the particular Article have been reproduced and indicates *the last* serial number of the group. These serial numbers appear in bold face type at the *end* of the special rulings themselves, within the Supplement.

**Caution.**—To the extent of the imposition of the excess-profits tax for 1921, the 1918 and 1921 laws are identical, except that domestic corporations entitled to the benefits of Section 262 of the 1921 Act (§1083) are grouped with foreign corporations for the purposes of the 1921 excess-profits tax. To much the same extent, with like qualifications, the provisions of Regulations 62 (1921 Act) are essentially identical (there are frequent verbal changes) to the provisions of Regulations 45 (1918 Act). The numbering of the Articles of Regulations 62 (1921 Act) is the same as that of the respective corresponding Articles of Regulations 45 (1918 Act), except as noted below. It follows then, that, except as noted below, for the purposes of the Supplementary Bulletin Rulings, the Article reference number is the same under either Act.

Reg. 62 (1921 Act)	Reg. 45 (1918 Act)
No corresponding Article.....	to Article 712
Article 712 is the same as, therefore refer to, Article 713	
“ 713 “ “ “ “ “ “ “ “ “ 714	
“ 714 “ “ “ “ “ “ “ “ “ 715	
“ 715 “ “ “ “ “ “ “ “ “ 716	
No corresponding Article.....	to Article 717
Article 716 is the same as, therefore refer to, Article 719	
“ 717 “ “ “ “ “ “ “ “ “ 718	
“ 718 “ “ “ “ “ “ “ “ “ 720	
No corresponding Article.....	to Article 869
Article 869 is the same as, therefore refer to, Article 870	
“ 870 “ “ “ “ “ “ “ “ “ 871	

**Otherwise**

Art. of Reg. 62 is same as, therefore refer to, same numbered Art. of Reg. 45  
*(The list is always up-to-date.)*

Law Section	Article Number	Last Ruling	Law Section	Article Number	Last Ruling
300.....	701.....	None	302.....	732.....	1
301.....	711.....	1	“.....	733.....	None
“.....	712.....	None	303.....	741.....	2
“.....	713.....	None	“.....	742.....	None
“.....	714.....	11	“.....	743.....	None
“.....	715.....	2	304.....	751.....	None
“.....	716.....	None	“.....	752.....	1
“.....	717.....	None	“.....	753.....	None
“.....	718.....	None	305.....	761.....	None
“.....	719.....	1	310.....	771.....	1
“.....	720.....	None	311.....	781.....	3
302.....	731.....	1	“.....	782.....	None

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"	815	9	"	864	None
"	816	1	"	865	None
"	817	1	"	866	None
"	818	3	"	867	None
326	831	42	"	868	None
"	832	None	"	869	1
"	833	5	"	870	None
"	834	1	"	871	1
"	835	4	327	901	30
"	836	18	328	911	2
"	837	5	"	912	3
"	838	10	"	913	1
"	839	4	"	914	2
"	840	10	330	931	4
"	841	5	"	932	1
"	842	None	"	933	7
"	843	2	"	934	None
"	844	1	331	941	18
"	845	10	335	951	None
"	845A	(See 845)	"	952	1
"	846	4	"	953	None
"	847	None	"	954	None
"	848	None	"	955	None
"	849	None	336	961	None
"	850	2	"	962	None
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## VOLUME II (1923), No. 11.

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Insert this page to face blue page 401.



In the audit of the case the Unit regarded the transactions under which the 23.3x dollars of common stock was issued (13.3x dollars for the leases and options and 10x dollars for prepaid services) as the purchase by the company of a contract, and in the computation of invested capital treated such contract as intangible property subject to the limitations prescribed by the Revenue Acts of 1917 and 1918. In the computation of net income the Unit allowed as a deduction in each of the years 1915 to 1918, inclusive, amortization at the rate of x dollars per year for that portion of the contract representing prepaid services, thereby treating the thing acquired by the company in consideration of the 10x dollars common stock as a deferred asset to be written off over the 10-year life of the contract.

In the opinion of the Committee such action was clearly in error. The resolution of the board of directors as recorded in the minutes clearly shows that the 13.3x dollars of common stock was issued for leases and options to lease certain definitely described real estate and such property is not subject to the limitations prescribed for intangibles. The 10x dollars of common stock was issued for services to be rendered in the future; that is, for an executory contract for the performance of services in the future. Courts have held that such a contract is not property within the requirements of the laws which provide that corporations shall not issue stock or bonds except for money, labor done, or property actually received. (See 125 N. Y. S., 572; 134 Fed., 341; 150 N. Y. S., 668.) Section 207 of the Revenue Act of 1917 and section 326 of the Revenue Act of 1918 provide for the inclusion in invested capital of the value of property paid in for stock or shares. The thing paid in must be property, and accordingly a promise to perform services in the future may not be taken into invested capital at any value. It appears reasonable, however, to treat A's agreement to serve the company as manager for a period of 10 years next ensuing, in consideration of the issue of common stock, as of the nature of a purchase of stock on the installment plan, and under this theory only that portion of the stock as represented services actually performed at the end of each year could be admitted as invested capital for the year next ensuing.

Nothing has been submitted to show specifically the fair value of the services rendered by A, although the earnings of the company for the first six years of its existence indicate that under his management it prospered exceedingly. The Committee feels, however, that the value per year fixed by agreement between A and the company is more controlling of the fair value of such services than the subsequent prosperity of the company. It is therefore recommended that x dollars be allowed in the computation of invested capital for each year's services as performed, and that in computing net income, no deduction be allowed in any year for amortization of the contract to render services.

Subsequent to the audit of the case by the Unit the Company requested permission to deduct from income for each year as a business expense of the year a percentage of the face value of redeemed theater passes issued for window display of posters, billboards, write-up in newspapers, personal services and rental of "props" for various acts. It is contended that the issue of passes for the purposes above named and the consequent necessity for the redemption of such passes with seats results in a loss to the company, because it frequently happens that prospective patrons must be advised that no seats are available, when the seats are desired are occupied by pass holders.

The Income Tax Unit takes the position that if gross income is to be charged with the value of the seats given for passes it should be credited with the same value when the passes are presented for redemption. The company admits that when the passes are redeemed income should be credited,

but not for the full value of the seats, inasmuch as the passes are restricted and because of such restrictions can not be sold by the persons to whom issued for more than one-half price. In brief, the company requests that it be permitted to charge gross income with the full value of the seats occupied by pass holders and to credit income with only one-half of such value. The Committee finds no merit in such a contention. If the passes are worth the full value of a seat when given in payment for privileges, services, etc., it appears to be entirely unreasonable to assume that they have a less value when presented for redemption.

In view of the foregoing, it is recommended, in the appeal of the M Company, that no deduction from gross income be allowed in any year under review for amortization of the contract for services of A nor for redeemed theater passes; that in the computation of invested capital for 1917 and 1918 the options and leases acquired for common stock be treated as tangible property and allowed at a value equal to the par value of the stock issued therefor; and that the 10x dollars common stock issued for services to be rendered be allowed only to the extent that services valued at x dollars per year have been rendered.

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## EXCISE TAXES REGULATIONS.

Getting the bill of lading stands no differently from putting the goods on board ship. Neither does it matter that the title was in Scholtz & Co. and that theoretically they might change their mind and retain the bats and balls for their own use. There was not the slightest probability of any such change and it did not occur. The purchase by Scholtz & Co. was solely for the purpose of Delgado & Cia. and for their account and risk. Theoretical possibilities may be left out of account. In *Railroad Commission of Louisiana v. Texas & Pacific Ry. Co.*, 229 U. S. 336, the consignees might have retained the goods at New Orleans instead of shipping them abroad. The fact that they came to New Orleans by rail from another place in the State made no difference. The same principle was applied in *Texas & New Orleans R. R. Co. v. Sabine Tram Co.*, 227 U. S. 111, 123. The overt act of delivering the goods to the carrier marks the point of distinction between this case and *Cornell v. Coyne*, 192 U. S. 418. To put it at any later point would fail to give to exports the liberal protection that hitherto they have received; of which an example may be seen in *Thames & Mersey Marine Ins. Co., Ltd. v. United States*, 237 U. S. 19.

Judgment reversed.

(T. D. 3485.)

**4771** **Time for filing returns and payment of sales taxes.**—The sixth sentence of Article 41, Regulations 43, (Part 1); the fifth sentence of 4665 Article 13, Regulations 43, (Part 2); the fourth sentence of Article 4752 Article 36, Regulations 47; the sixth sentence of Article 32, Regulations 48; the first sentence of Article 20, Regulations 52; and the second sentence of Article 35, Regulations 57, are hereby amended by inserting a comma at the end thereof, and adding the following: "except that when the last day of the month in which a return and payment are due falls on Sunday or a legal holiday, the return may be filed and payment made to the Collector of Internal Revenue or Deputy Collector on the next secular or business day." (T. D. 3485, signed by Commissioner D. H. Blair, and dated June 1, 1923.)





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*(Decision.)*

## 1917 Tax on Individuals.

**1327 Commissions on certain renewal insurance premiums.**—[Comment:

In *Woods vs. Lewellyn*, Collector, U. S. District Court for the Western District of Pennsylvania (No. 2630, November Term, 1921), decided March 14, 1923, Judge Gibson holds that commissions received by Mr. Woods in 1917 on renewal premiums on insurance, previously written by him were not to be included in income subject to excess-profits tax under the existing circumstances, the facts being: The insurance was written by Mr. Woods during the time he was acting as General Agent of the Equitable Life Assurance Company; he had ceased to be such at the beginning of 1917; during all of 1917 he was president and manager (at a salary of \$30,000) of an incorporated life insurance agency known as the Edward A. Woods Agency, which acted as General Agent of the Equitable Life Assurance Company; Mr. Woods had not transferred to the corporation his rights in the renewal commissions; he earned during 1917 \$2,787.33 in commissions on insurance written by him personally, and claimed as a business-expense deduction, personally, \$4,600. The court holds that the business engaged in by Mr. Woods was that of acting as president and manager of the corporation; that his earnings during the year from insurance written personally, were so small, as compared with his salary, as not to constitute earnings from a regular trade or business, but rather as earnings from more or less isolated transactions; that the expenses might well have been due to the exercise of an incidental or isolated activity; and that thus, not being engaged in the business of writing insurance, the renewal commissions received by Mr. Woods did not constitute income from his trade or business. In conclusion the court says: "As heretofore stated, it is our opinion that the sums sought by the Collector to be subjected to taxation as excess profits were not earned by plaintiff in the exercise of the vocation pursued by him in 1917, and were not rightfully collected. It is needless, therefore, for us to consider the forcible argument of counsel for plaintiff to establish the claim that the renewal premiums in question were 'the income from property arising merely from ownership, including interest, rent, and similar income from investments,' and as such declared not the subject to the excess profits tax by Article 8 of Regulation No. 41, issued by the Commissioner of Internal Revenue. Counsel has pointed out the fact that plaintiff would have received these premiums if he had retired from business altogether prior to 1917, and that they would have been paid to his heirs had he died in the latter part of 1916. This makes it plain, he claims, that the sums received by him as premiums, constituted income derived from property rights acquired prior to 1917, and not the fruits of his vocation or 'trade or business' in that year. His contention in this respect is doubtless worthy of serious consideration, in case the necessity for such consideration were to arise."—The Corporation Trust Company.]





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**STAMP TAX REGULATIONS.**

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(Rich v. Doneghy, supra.) It is accordingly subject to the tax imposed by Schedule A-6, Title XI, of the Revenue Act of 1921. The provisions of the instrument designated "Oil and Gas Lease" clearly show that it was intended to and in fact operates as an oil and gas lease and vests no right to the lessee in the real estate, nor any interest therein or any right thereto, save to explore for oil, etc. (Kelly v. Harris, 162 Pac. 129 (Okla.)). It is, therefore, not subject to the tax imposed by Schedule A-6. See Article 87 of Regulations 55 (1922 Edition) [¶3866]. (Letter to The Corporation Trust Company, signed by Deputy Commissioner F. G. Matson, and dated April 28, 1923.)



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## UNINDEXED SUPPLEMENTARY ESTATE TAX REGULATIONS, ETC.

**E511** It is the intent of the statute that charitable bequests shall not be taxed. By its regulation of the incidence of the tax, New York does in fact diminish in favor of the United States what the charities receive; but it must be wrong for the executive departments of the United States to use the rule of incidence, which is of state creation, to increase its own exactions.

**E512** As Holmes, J. remarked in the New York Trust Co. case, *supra*, "Upon this point a page of history is worth a volume of logic." History, so far as we can discover, shows no other instance of attempting to measure a tax *pro tanto* by itself. As Hand, J., said in the court below, this theory departs from long established practice and from the usage if not the law of never regarding the incidence of a tax in the levying of a tax.

**E513** So far as authority goes, *Dugan vs. Miles*, 276 Fed., 401, is the only decision suggested on this branch of the statute. The facts in that litigation were legally identical with those at bar; yet it is true that the doctrine here contended for by the Treasury was not alluded to by the experienced and able Judge who wrote opinion, although his result is consistent only with the methods pursued by these defendants-in-error. The inference is that neither the Judge nor counsel on either side thought of such a theory—which does not seem to us surprising.

**E514** Being of opinion, therefore, that the scheme of taxation insisted on by plaintiff-in-error is unjust, opposed to long-established practice and the spirit of the statute, that it is not required by the language of the act, and tends to confusion taking the country over—the judgment below [¶306] should be and is affirmed, with costs.

[Petition for writ of certiorari granted by U. S. Supreme Court, May 7, 1923, in the case reported above.]

(T. D. 3487.)

**E515** Estate Tax—Reservation of Powers.—Article 21 of Regulations 63, 125 and Article 25 of Regulations 37 [1918 Act], are hereby amended to read as follows:

"Reservation of powers.—Where a transfer by trust or otherwise is subject to revocation by the donor, or the terms thereof may be altered or amended by him, or he reserves to himself the right to take or assume either full or partial control of the transferred property, or to direct or control the management thereof, all facts and circumstances bearing upon the donor's intent are to be considered, and if it appears that he intended the transfer to take effect in possession or enjoyment at or after his death, then the value of the transferred property should be included in the gross estate, unless it further appears that the transfer was a bona fide sale for a fair consideration in money or money's worth." (T. D. 3487, signed by Commissioner D. H. Blair, and dated June 6, 1923.)





**FORMS, FINDER, ETC.****MASSACHUSETTS** (Comprising the State of Massachusetts),

Collector: Malcolm E. Nichols, Boston.

Div. Hdqrs. at: Springfield, Worcester, Fall River, Lawrence.

**MICHIGAN**

First District.—Comprising that part of the State of Michigan included in the following counties: Alcona, Alpena, Arenac, Bay, Branch, Calhoun, Cheboygan, Clare, Clinton, Crawford, Genesee, Gladwin, Gratiot, Hillsdale, Huron, Ingham, Iosco, Isabella, Jackson, Lapeer, Lenawee, Livingston, Macomb, Midland, Monroe, Montgomery, Oakland, Ogemaw, Oscoda, Otsego, Presque Isle, Roscommon, Saginaw, Sanilac, Shiawassee, St. Clair, Tuscola, Washtenaw, and Wayne.

Collector: Fred L. Woodworth, Detroit.

Div. Hdqrs. at: Bay City,\* Jackson, Flint.

Stamp Office at: Saginaw.

Fourth District.—Comprising that part of that State of Michigan included in the following counties: Alger, Allegan, Antrim, Baraga, Barry, Benzie, Berrien, Cass, Charlevoix, Chippewa, Delta, Dickinson, Eaton, Emmet, Gogebic, Grand Traverse, Houghton, Ionia, Iron, Kalamazoo, Kalkaska, Kent, Keweenaw, Lake, Leelanau, Luce, Mackinac, Manistee, Marquette, Mason, Mecosta, Menominee, Missaukee, Montcalm, Muskegon, Newaygo, Oceana, Ontonagon, Osceola, Ottawa, St. Joseph, Schoolcraft, Van Buren, and Wexford.

Collector: Charles Holden, Grand Rapids.

Div. Hdqrs. at: Kalamazoo, Marquette.

**MINNESOTA** (Comprising the State of Minnesota),

Collector: Levi M. Willcuts, St. Paul.

Div. Hdqrs. at: Minneapolis,\* Duluth,\* Winona, Mankato, St. Cloud.

**MISSISSIPPI** (Comprising the State of Mississippi),

Collector: George McDonald, Jackson.

Div. Hdqrs. at: Meridan, Greenwood.

**MISSOURI**

First District.—Comprising that part of the State of Missouri included in the following counties: Adair, Audrain, Bollinger, Boone, Butler, Callaway, Cape Girardeau, Carter, Clark, Crawford, Dent, Dunklin, Franklin, Gasconade, Howard, Iron, Jefferson, Knox, Lewis, Lincoln, Linn, Macon, Madison, Maries, Marion, Mississippi, Montgomery, Monroe, New Madrid, Oregon, Osage, Pemiscot, Perry, Phelps, Pike, Pulaski, Ralls, Randolph, Reynolds, Ripley, St. Charles, St. Francois, Ste. Genevieve, St. Louis, Schuyler, Scotland, Scott, Shannon, Shelby, Stoddard, Warren, Washington, and Wayne.

Collector: Arnold J. Hellmich, St. Louis.

Div. Hdqrs. at: Hannibal, Cape Girardeau.

Sixth District.—Comprising that part of the State of Missouri included in the following counties: Andrew, Atchison, Benton, Barry, Barton, Bates, Buchanan, Caldwell, Camden, Carroll, Cass, Cedar, Charlton, Christian, Clay, Clinton, Cole, Cooper, Dade, Dallas, Daviess, Dekalb, Douglas, Gentry, Greene, Grundy, Harrison, Henry, Hickory, Holt, Howell, Jackson, Jasper, Johnson, Laclede, Lafayette, Lawrence, Livingston, McDonald, Mercer, Miller, Moniteau, Morgan, Newton, Nodaway, Ozark, Pettis, Platte, Polk, Putnam, Ray, St. Clair, Saline, Stone, Sullivan, Taney, Texas, Vernon, Webster, Worth, and Wright.

Collector: Noah Crooks, Kansas City.

Div. Hdqrs. at: St. Joseph,\* Springfield.

Stamp Office at: Joplin.

**MONTANA** (Comprising the State of Montana),

Collector: Charles A. Rasmussen, Helena.

Div. Hdqrs. at: Butte,\* Great Falls, Billings.

**NEBRASKA** (Comprising the State of Nebraska),

Collector: Arthur B. Allen, Omaha.

Div. Hdqrs. at: Lincoln, Grand Island.

**NEVADA** (Comprising the State of Nevada),

Collector: Louis A. Spellier, Reno.

**NEW HAMPSHIRE** (Comprising the State of New Hampshire),

Collector: John H. Field, Portsmouth.

Stamp Office at: Manchester.

\*Stamps sold.

## FORMS, FINDER, ETC.

## NEW JERSEY

**First District.**—Comprising that part of the State of New Jersey included in the following counties: Atlantic, Burlington, Camden, Cape May, Cumberland, Gloucester, Mercer, Monmouth, Ocean, and Salem.

**Collector:** Edward L. Sturgess, Camden.

**Div. Hdqrs. at:** Trenton.

**Fifth District.**—Comprising that part of the State of New Jersey included in the following counties: Bergen, Essex, Hudson, Hunterdon, Middlesex, Morris, Passaic, Somerset, Sussex, Union, Warren.

**Collector:** Frank C. Ferguson, Newark.

**Div. Hdqrs. at:** Jersey City,\* Paterson,\* Elizabeth, Morristown.

**Stamp Office at:** New Brunswick.

## NEW MEXICO (Comprising the State of New Mexico),

**Collector:** Benigno C. Hernandez, Albuquerque.

## NEW YORK

**First District.**—Comprising that part of the State of New York included in the following counties: Kings, Nassau, Queens, Richmond, and Suffolk.

**Collector:** John T. Rafferty, Brooklyn.

**Div. Hdqrs. at:** Patchogue.

**Second District.**—Comprising the County of New York, N. Y., and those three certain islands situated in the East River known as Randalls Island, Wards Island and Blackwells Island.

**Collector:** Frank K. Bowers, New York.

**Div. Hdqrs. at:** 4 Union Square, 1416 Broadway, 1819 Broadway,\* 310 Lenox Ave.\*

**Stamp Office at:** San Juan, P. R.

**Fourteenth District.**—Comprising that part of the State of New York included in the following counties: Albany, Bronx (formerly the 23rd and 24th wards of New York City), Clinton, Columbia, Dutchess, Essex, Fulton, Greene, Hamilton, Montgomery, Orange, Putnam, Rensselaer, Rockland, Saratoga, Schenectady, Schoharie, Sullivan, Ulster, Warren, Washington, and Westchester.

**Collector:** Cyrus Durey, Albany.

**Div. Hdqrs. at:** Schenectady, Troy, Newburgh, Bronx,\* 1932 Arthur Ave., N. Y. City, Poughkeepsie.

**Stamp Office at:** Peekskill.

**Twenty-first District.**—Comprising that part of New York included in the following counties: Broome, Cayuga, Chenango, Cortland, Delaware, Franklin, Herkimer, Jefferson, Lewis, Madison, Oneida, Onondaga, Oswego, Otsego, St. Lawrence, Schuyler, Seneca, Tioga, Tompkins, and Wayne.

**Collector:** Jesse W. Clarke, Syracuse.

**Div. Hdqrs. at:** Utica,\* Binghamton,\* Watertown.

**Twenty-eighth District.**—Comprising that part of New York included in the following counties: Allegany, Cattaraugus, Chautauqua, Chemung, Erie, Genesee, Livingston, Monroe, Niagara, Ontario, Orleans, Steuben, Wyoming, and Yates.

**Collector:** Bert P. Gage, Buffalo.

**Div. Hdqrs. at:** Rochester,\* Elmira,\* Jamestown.

## NORTH CAROLINA (Comprising the State of North Carolina),

**Collector:** Gilliam Grissom, Raleigh.

**Div. Hdqrs. at:** Washington, Wilmington, Charlotte, Asheville, Winston-Salem.\*

**Stamp Offices at:** Durham, Reidsville, Statesville, Greensboro.

## NORTH DAKOTA (Comprising the State of North Dakota),

**Collector:** Gunder Olson, Fargo.

**Div. Hdqrs. at:** Grand Forks.

\*Stamps sold.



## FORMS, FINDER, ETC.

## OHIO

**First District.**—Comprising that part of the State of Ohio included in the following counties: Brown, Butler, Clarke, Clermont, Clinton, Fayette, Greene, Hamilton, Highland, Miami, Montgomery, Preble, and Warren.

**Collector:** Charles M. Dean, Cincinnati.

**Div. Hdqrs. at:** Dayton.\*

**Stamp Offices at:** Middletown, Hamilton.

**Tenth District.**—Comprising that part of the State of Ohio included in the following counties: Allen, Auglaize, Champaign, Crawford, Darke, Defiance, Erie, Fulton, Hancock, Hardin, Henry, Huron, Knox, Lucas, Mercer, Ottawa, Paulding, Putnam, Sandusky, Seneca, Shelby, Van Wert, Williams, Wood, and Wyandot.

**Collector:** Charles H. Nauts, Toledo.

**Eleventh District.**—Comprising that part of the State of Ohio included in the following counties: Adams, Athens, Coshocton, Delaware, Fairfield, Franklin, Gallia, Guernsey, Hocking, Jackson, Knox, Lawrence, Licking, Madison, Marion, Meigs, Morgan, Morrow, Muskingum, Noble, Perry, Pickaway, Pike, Ross, Scioto, Union, Vinton, and Washington.

**Collector:** Newton M. Miller, Columbus.

**Div. Hdqrs. at:** Portsmouth, Zanesville.

**Eighteenth District.**—Comprising that part of the State of Ohio included in the following counties: Ashland, Ashtabula, Belmont, Carroll, Columbiana, Cuyahoga, Geauga, Harrison, Holmes, Jefferson, Lake, Lorain, Mahoning, Medina, Monroe, Portage, Richland, Stark, Summit, Trumbull, Tuscarawas, and Wayne.

**Collector:** Carl F. Routzahn, Cleveland.

**Div. Hdqrs. at:** Akron, Canton, Youngstown, Steubenville.

## OKLAHOMA (Comprising the State of Oklahoma),

**Collector:** David C. Bennington, Oklahoma City.

**Div. Hdqrs. at:** Tulsa, Muskogee, McAlester, Enid.

## OREGON (Comprising the State of Oregon),

**Collector:** Clyde G. Huntley, Portland.

**Div. Hdqrs. at:** Eugene, Pendleton.

## PENNSYLVANIA

**First District.**—Comprising that part of the State of Pennsylvania included in the following counties: Adams, Bedford, Berks, Blair, Bucks, Chester, Cumberland, Dauphin, Delaware, Franklin, Fulton, Huntingdon, Juniata, Lancaster, Lebanon, Lehigh, Mifflin, Montgomery, Perry, Philadelphia, Schuylkill, Snyder, and York.

**Collector:** Blakely D. McCaughn, Philadelphia.

**Div. Hdqrs. at:** Philadelphia (2), Allentown,\* Altoona, Chester, Harrisburg,\* Lancaster,\* Norristown, Pottsville,\* Reading,\* York.\*

**Twelfth District.**—Comprising that part of the State of Pennsylvania included in the following counties: Bradford, Carbon, Center, Clinton, Columbia, Lackawanna, Luzerne, Lycoming, Monroe, Montour, Northampton, Northumberland, Pike, Potter, Sullivan, Susquehanna, Tioga, Union, Wayne, Wyoming.

**Collector:** David W. Phillips, Scranton.

**Div. Hdqrs. at:** Wilkesbarre,\* Easton,\* Shamokin.

**Twenty-third District.**—Comprising that part of the State of Pennsylvania included in the following counties: Allegheny, Armstrong, Beaver, Butler, Cambria, Cameron, Clarion, Clearfield, Crawford, Elk, Erie, Fayette, Forest, Green, Indiana, Jefferson, Lawrence, McKean, Mercer, Venango, Warren, Washington, and Westmoreland.

**Collector:** Daniel B. Heiner, Pittsburgh.

**Div. Hdqrs. at:** Erie,\* Uniontown,\* New Castle, Du Bois, Johnstown.

## RHODE ISLAND (Comprising the State of Rhode Island),

**Collector:** Frank A. Page, Providence.

## SOUTH CAROLINA (Comprising the State of South Carolina),

**Collector:** John F. Jones, Columbia.

## SOUTH DAKOTA (Comprising the State of South Dakota),

**Collector:** Leslie Jensen, Aberdeen.

**Div. Hdqrs. at:** Sioux Falls.

## TENNESSEE (Comprising the State of Tennessee),

**Collector:** Louis P. Brewer, Nashville.

**Div. Hdqrs. at:** Memphis,\* Chattanooga,\* Knoxville.\*

\*Stamps sold.

## TEXAS

**First District.**—Comprising that part of the State of Texas included in the following counties: Aransas, Atascosa, Austin, Bandera, Bastrop, Bee, Bell, Bexar, Blanco, Bosque, Brazoria, Brazos, Brewster, Brooks, Burleson, Burnet, Caldwell, Calhoun, Cameron, Chambers, Colorado, Comal, Coryell, Culberson, Dewitt, Dimmit, Dunn, Duval, Edwards, El Paso, Falls, Fayette, Fort Bend, Freestone, Frio, Galveston, Gillespie, Goliad, Gonzales, Grimes, Guadalupe, Hamilton, Hardin, Harris, Hays, Hidalgo, Hill, Hudspeth, Jackson, Jasper, Jeff Davis, Jefferson, Jim Hogg, Jim Wells, Karnes, Kendall, Kerr, Kimble, Kinney, Kleberg, Lampasas, La Salle, Lavaca, Lee, Leon, Liberty, Limestone, Live Oak, Llano, McCulloch, McLennan, McMullen, Madison, Mason, Matagorda, Maverick, Medina, Milam, Montgomery, Newton, Nueces, Orange, Pecos, Polk, Presidio, Real, Reeves, Refugio, Robertson, San Jacinto, San Patricio, San Saba, Somervell, Starr, Terrell, Travis, Trinity, Tyler, Uvalde, Val Verde, Victoria, Walker, Waller, Washington, Webb, Wharton, Willacy, Williamson, Wilson, Zapata, and Zavalla.

**Collector:** James W. Bass, Austin.

**Div. Hdqrs. at:** San Antonio, \* Houston, \* El Paso, Waco.\*

**Second District.**—Comprising that part of the State of Texas included in the following counties: Anderson, Andrews, Angelina, Archer, Armstrong, Bailey, Baylor, Borden, Bowie, Briscoe, Brown, Callahan, Camp, Carson, Cass, Castro, Cherokee, Childress, Clay, Cochran, Coke, Coleman, Collin, Collingsworth, Comanche, Concho, Cooke, Cottle, Crane, Crockett, Crosby, Dallam, Dallas, Dawson, Deaf Smith, Delta, Denton, Dickens, Donley, Eastland, Ector, Ellis, Erath, Fannin, Fisher, Floyd, Foard, Franklin, Gaines, Garza, Glasscock, Gray, Grayson, Gregg, Hale, Hall, Hansford, Hardeman, Harrison, Hartley, Haskell, Hemphill, Henderson, Hockley, Hood, Hopkins, Houston, Howard, Hunt, Hutchinson, Irion, Jack, Johnson, Jones, Kaufman, Kent, King, Knox, Lamar, Lamb, Lipscomb, Loving, Lubbock, Lynn, Marion, Martin, Menard, Midland, Mills, Mitchell, Montague, Moore, Morris, Motley, Nacogdoches, Navarro, Nolan, Ochilree, Oldham, Palo Pinto, Panola, Parker, Parmer, Potter, Rains, Randall, Reagan, Red River, Roberts, Rockwall, Runnels, Rusk, Sabine, San Augustine, Schleicher, Scurry, Shackelford, Shelby, Sherman, Smith, Stephens, Sterling, Stonewall, Sutton, Swisher, Tarrant, Taylor, Terry, Throckmorton, Titus, Tom Green, Upshur, Upton, Van Zandt, Ward, Wheeler, Wichita, Winkler, Wise, Wood, Yoakum, and Young.

**Collector:** George C. Hopkins, Dallas.

**Div. Hdqrs. at:** Wichita Falls, Fort Worth, Abilene, Tyler.

## UTAH (Comprising the State of Utah);

**Collector:** James H. Anderson, Salt Lake City.

**Stamp Office at:** Ogden.

## VERMONT (Comprising the State of Vermont),

**Collector:** Robert W. McCuen, Burlington.

## VIRGINIA (Comprising the State of Virginia),

**Collector:** John C. Noel, Richmond.

**Div. Hdqrs. at:** Norfolk, \* Lynchburg, \* Roanoke, \* Alexandria.\*

**Stamp Offices at:** Petersburg, Martinsville, Danville.

## WASHINGTON (Comprising the State of Washington and the Territory of Alaska),

**Collector:** Burns Poe, Tacoma.

**Div. Hdqrs. at:** Seattle, \* Spokane.

## WEST VIRGINIA (Comprising the State of West Virginia),

**Collector:** Albert B. White, Parkersburg.

**Div. Hdqrs. at:** Wheeling, \* Charleston, Huntington, \* Clarksburg.

**Stamp Offices at:** Fairmont.

## WISCONSIN (Comprising the State of Wisconsin),

**Collector:** Alonzo H. Wilkinson, Milwaukee.

**Div. Hdqrs. at:** Madison, \* Green Bay, Oshkosh, Superior, La Crosse, Racine.

## WYOMING (Comprising the State of Wyoming),

**Collector:** Marshall S. Reynolds, Cheyenne.

\*Stamps sold.

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WAR TAX 1716 SERVICE



**INTERNAL REVENUE COLLECTION DISTRICTS**

Including

NAMES AND ADDRESSES OF COLLECTORS AND LOCATION OF  
BRANCH OFFICES.

(Corrected to November 25, 1922)

**ALABAMA** (Comprising the State of Alabama),  
**Collector:** William E. Snead, Birmingham.  
**Div. Hdqrs. at:** Mobile, Montgomery.

**ALASKA** (See Washington).

**ARIZONA** (Comprising the State of Arizona),  
**Collector:** Frank R. Stewart, Phoenix.

**ARKANSAS** (Comprising the State of Arkansas),  
**Collector:** Harmon L. Remmel, Little Rock.  
**Div. Hdqrs. at:** Fort Smith, Helena.

**CALIFORNIA**

First District.—Comprising the following counties in California: Alameda, Alpine, Amador, Butte, Calaveras, Clousa, Contra Costa, Del Norte, Eldorado, Fresno, Glenn, Humboldt, Inyo, Kings, Lake, Lassen, Madera, Marin, Mariposa, Mendocino, Merced, Modoc, Mono, Monterey, Napa, Nevada, Placer, Plumas, Sacramento, San Benito, San Francisco, San Joaquin, San Mateo, Santa Clara, Santa Cruz, Shasta, Sierra, Siskiyou, Solano, Sonoma, Stanislaus, Sutter, Tulare, Tehama, Trinity, Tuolumne, Yolo and Yuba.

**Collector:** John P. McLaughlin, San Francisco.  
**Div. Hdqrs. at:** Sacramento,\* Oakland,\* Stockton.  
**Stamp Office at:** Fresno.

Sixth District.—Comprising that part of California included in the following counties: Imperial, Kern, Los Angeles, Orange, Riverside, San Bernardino, San Diego, San Luis Obispo, Santa Barbara and Ventura.

**Collector:** Rex. B. Goodcell, Los Angeles.  
**Div. Hdqrs. at:** San Diego,\* San Bernardino, Santa Barbara.

**COLORADO** (Comprising the State of Colorado),  
**Collector:** Frank W. Howbert, Denver.

**CONNECTICUT** (Comprising the State of Connecticut),  
**Collector:** Robert O. Eaton, Hartford.  
**Div. Hdqrs. at:** Bridgeport,\* New Haven,\* Waterbury New London.

**DELAWARE** (Comprising the State of Delaware),  
**Collector:** John W. Hering, Wilmington.

**DISTRICT OF COLUMBIA** (See Maryland).

**FLORIDA** (Comprising the State of Florida),  
**Collector:** Daniel T. Gerow, Jacksonville.  
**Div. Hdqrs. at:** Tampa,\* Pensacola, Miami.  
**Stamp Office at:** Key West.

**GEORGIA** (Comprising the State of Georgia),  
**Collector:** Josiah T. Rose, Atlanta.  
**Div. Hdqrs. at:** Macon and Savannah.

**HAWAII** (Comprising the Territory of Hawaii),  
**Collector:** J. Walter Jones, Honolulu.  
**Stamp Office at:** Hilo.

\*Stamps sold.

**FORMS, FINDER, ETC.****IDAHO** (Comprising the State of Idaho),**Collector:** Evan Evans Boise.**Div. Hdqrs. at:** Poocatello.**ILLINOIS**

**First District.**—Comprising that part of the State of Illinois included in the following counties: Boone, Bureau, Carroll, Cook, Dekalb, Dupage, Grundy, Henderson, Henry, Jo Daviess, Kane, Kankakee, Kendall, Knox, Lake, LaSalle, Lee, McHenry, Marshall, Mercer, Ogle, Peoria, Putnam, Rock Island, Stark, Stephenson, Warren, Whiteside, Will, and Winnebago.

**Collector:** John C. Cannon, Chicago.**Div. Hdqrs. at:** Chicago (five), Joliet, Rock Island,\* Peoria,\* Rockford, Aurora.

**Eight District.**—Comprising that part of the State of Illinois included in the following counties: Adams, Alexander, Bond, Brown, Calhoun, Cass, Champaign, Christian, Clark, Clay, Clinton, Coles, Crawford, Cumberland, Dewitt, Douglas, Edgar, Edwards, Effingham, Fayette, Ford, Franklin, Fulton, Gallatin, Greene, Hamilton, Hancock, Hardin, Iroquois, Jackson, Jasper, Jefferson, Jersey, Johnson, Lawrence, Livingston, Logan, McDonough, McLean, Macon, Macoupin, Madison, Marion, Mason, Massac, Menard, Monroe, Montgomery, Morgan, Moultrie, Perry, Platt, Pike, Pope, Pulaski, Randolph, Richland, St. Clair, Saline, Sangamon, Schuyler, Scott, Shelby, Tazewell, Union, Vermilion, Wabash, Washington, Wayne, White, Williamson, and Woodford.

**Collector:** George W. Schwaner, Springfield.**Div. Hdqrs. at:** East St. Louis,\* Cairo, Centralia, Danville,\* Decatur,\* Bloomington, Quincy.\***Stamp Offices at:** Pekin, Jacksonville, Canton.**INDIANA** (Comprising the State of Indiana),**Collector:** M. Bert Thurman, Indianapolis.**Div. Hdqrs. at:** Gary, South Bend,\* Ft. Wayne,\* Logansport, Lafayette,\* Muncie, New Albany, Evansville,\* Terre Haute.\***Stamp Office at:** Lawrenceburg.**IOWA** (Comprising the State of Iowa),**Collector:** Lars E. Bladine, Dubuque.**Div. Hdqrs. at:** Davenport,\* Des Moines,\* Ottumwa,\* Sioux City,\* Cedar Rapids, Council Bluffs, Mason City.**Stamp Office at:** Burlington.**KANSAS** (Comprising the State of Kansas),**Collector:** Harvey H. Motter, Wichita.**Div. Hdqrs. at:** Kansas City,\* Parsons, Topeka, Salina.**KENTUCKY** (Comprising the State of Kentucky),**Collector:** Robert H. Lucas, Louisville.**Div. Hdqrs. at:** Ashland, Paducah,\* Owensboro,\* Lexington,\* Covington.\***Stamp Offices at:** Danville, Frankfort.**LOUISIANA** (Comprising the State of Louisiana),**Collector:** D. Arthur Lines, New Orleans.**Div. Hdqrs. at:** Shreveport, Baton Rouge.**MAINE** (Comprising the State of Maine),**Collector:** Frank J. Ham, Augusta.**Div. Hdqrs. at:** Portland, Bangor.**MARYLAND** (Comprising the State of Maryland and the District of Columbia),**Collector:** Galen L. Tait, Baltimore.**Div. Hdqrs. at:** Washington, D. C.,\* Hagerstown, Salisbury.

\*Stamps sold.



The Foreword to the Supplementary Rulings should be read.

**Caution.**—To the extent of the imposition of the excess-profits tax for 1921, the 1918 and 1921 laws are identical, except that domestic corporations entitled to the benefits of Section 262 of the 1921 Act (§1083) are grouped with foreign corporations for the purposes of the 1921 excess-profits tax. To much the same extent, with like qualifications, the provisions of Regulations 62 (1921 Act) are essentially identical (there are frequent verbal changes) to the provisions of Regulations 45 (1918 Act). The numbering of the Articles of Regulations 62 (1921 Act) is the same as that of the respective corresponding Articles of Regulations 45 (1918 Act), except as noted below. It follows then, that, except as noted below, for the purposes of the Supplementary Bulletin Rulings, the Article reference number is the same under either Act.

Reg. 62 (1921 Act)	Reg. 45 (1918 Act)
No corresponding Article.....	to Article 712
Article 712 is the same as, therefore refer to, Article	713
" 713 " " " " " " " " " " " "	714
" 714 " " " " " " " " " " " "	715
" 715 " " " " " " " " " " " "	716
No corresponding Article.....	to Article 717
Article 716 is the same as, therefore refer to, Article	719
" 717 " " " " " " " " " " " "	718
" 718 " " " " " " " " " " " "	720
No corresponding Article.....	to Article 869
Article 869 is the same as, therefore refer to, Article	870
870 " " " " " " " " " " " "	871

(The list is always up-to-date.)

Law Section	Article Number	Last Ruling	Law Section	Article Number	Last Ruling
300	701	None	302	732	1
301	711	1	"	733	None
"	712	None	303	741	2
"	713	None	"	742	None
"	714	11	"	743	None
"	715	2	304	751	None
"	716	None	"	752	1
"	717	None	"	753	None
"	718	None	305	761	None
"	719	1	310	771	1
"	720	None	311	781	3
302	731	1	"	782	None

Insert immediately preceding blue page 401.

Law Section	Article Number	Last Ruling	Law Section	Article Number	Last Ruling
311	783	1	326	854	2
"	784	None	"	855	1
"	785	None	"	856	None
312	791	3	"	857	6
320	801	1	"	858	10
"	802	1	"	859	2
325	811	2	"	860	1
"	812	3	"	861	None
"	813	10	"	862	3
"	814	None	"	863	None
"	815	9	"	864	None
"	816	1	"	865	None
"	817	1	"	866	None
"	818	3	"	867	None
326	831	42	"	868	None
"	832	None	"	869	1
"	833	5	"	870	None
"	834	1	"	871	1
"	835	3	327	901	30
"	836	18	328	911	2
"	837	5	"	912	3
"	838	10	"	913	1
"	839	4	"	914	2
"	840	10	330	931	4
"	841	5	"	932	1
"	842	None	"	933	7
"	843	2	"	934	None
"	844	1	331	941	18
"	845	10	335	951	None
"	845A	(See 845)	"	952	1
"	846	4	"	953	None
"	847	None	"	954	None
"	848	None	"	955	None
"	849	None	336	961	None
"	850	2	"	962	None
"	851	6	337	971	2
"	852	1	"	972	None
"	853	1	338	981	None

Every Article of Regulations 45 (1918 Act) and of Regulations 62 (1921 Act) bearing specifically on the war-profits and excess-profits tax is listed in the foregoing table. The first Article is 701.

Missing Article numbers such as 702 to 710 have not yet been used.

*The last Bulletin from which rulings have been reproduced hereinbefore and as listed above is*

VOLUME II (1923), No. 8.

*Later Bulletins, since issued (if any), contain no rulings bearing on the 1918 or 1921 excess-profits tax laws.*

Insert this page to face blue page 401.



above. This applied, however, only in so far as it relates to property acquired at the time of the merger and it may be that some part of the intangible property in the form of trade-marks or trade brands so transferred may have been acquired for cash or tangible property since that date. Proper recognition should, of course, be given to the facts in such an event.

(3) The W Company acquired through the merger already mentioned the stock of certain subsidiary companies. In the computation of the consolidated invested capital the Income Tax Unit has treated the acquisition of the stock of these subsidiary companies in the same manner as if the tangible and intangible assets of the respective companies had been acquired. In some cases these subsidiary companies have since been dissolved and upon dissolution the assets have been taken up by the parent company and the liabilities assumed by it. In the opinion of the Advisory Tax Board the method of computation used by the unit as above stated is correct.

(4) The W Company makes claim for prewar deduction of 9 per cent, although its actual earnings during the prewar period amount to less than this percentage of its invested capital. Representative corporations, however, show more than 9 per cent, and the W Company would have shown more than 9 per cent except for a charge that occurred during this period by way of premium paid upon certain bonds of the company which it had called in and canceled pursuant to the dissolution decree.

In view of all these circumstances, the Advisory Tax Board concurs in the decision of the Income Tax Unit that the taxpayer's claim should be allowed.

2

44-20-1282: A. R. R. 307.

The Committee has had under consideration the appeal of the N Company against the ruling of the Income Tax Unit disallowing an item of 50x dollars claimed as good will in its invested capital for 1918.

The facts appear to be that the N Company, a corporation, succeeded N and Company, a partnership, in 1897. The partnership had been very profitable prior to incorporation, its average earnings for the five years just prior to 1897 being approximately 100x dollars. As its tangible assets presumably were substantially the same as when turned over to the corporation in 1897, 200x dollars, it is clear that its earnings indicated a good will worth at least as much as the tangible assets. The deed transferring assets to the corporation specifically recited that the 200x dollars in stock was paid for the trade name and good will of the business and the physical assets. The amount of the net tangible assets taken up on the books of the corporation was 200x dollars, the good will not being carried on the books as an asset at all.

The denial of the item of 50x dollars claimed as invested capital appears to be based upon the assumption that if allowed at all it must be allowed as paid-in surplus, and the Unit has consistently and correctly, in the opinion of the Committee, taken the attitude that no paid-in surplus is permissible directly or indirectly as to intangible assets conveyed. However, this amount may be allowed without its inclusion as paid-in surplus. The tangible assets taken over were raw materials and stock in trade which were sold long prior to any income tax law. To distribute the purchase price of the tangibles and intangibles purchased as being 150x dollars for tangibles and 50x dollars for intangibles will have the effect of reducing the cost price of assets from

200x dollars to 150x dollars and consequently increasing the earned surplus by 50x dollars.

It is clear that this is a case of acquisition for stock of a mixed aggregate of tangibles and intangibles such as would justify the application of section 327 if satisfactory allocation of values can not be arrived at. In view of the history of the concern and the profits earned in excess of a return upon tangible assets, the Committee is clearly of the opinion that the intangible assets were as readily worth 50x dollars as the tangibles were worth 150x dollars. However, as 50x dollars in 1918 is the maximum value which can be included in invested capital by reason of the purchase of intangible assets for stock, the Committee recommends that the corporation be allowed to allocate the values at the time of purchase and to attribute to the tangibles a cost of 150x dollars and to the intangibles a cost of 50x dollars, and to adjust its books so as to increase its earned surplus by the sum of 50x dollars.

3



*Decision.*

(January 31, 1917.)

**Suit to Enjoin Collection of Penalties.**

District Court, N. D. Illinois, E. D.

Kohlhamer vs. Smietanka, Collector.

(239 Fed. 408.)

**8045** While Section 3224 R. S. [§8038] which prohibits suits to enjoin the collection of internal revenue taxes, does not specifically include "penalties" as such, yet where penalties are authorized by statute to be added to the tax and collected as a part of the tax, the court will hold that the penalty is a part of the tax, the assessment and collection of which are governed by Section 3224. (239 Fed. 408.)

**Fraudulent Returns.**

**8046** (Law.) Sec. 1323 [of the Revenue Act of 1921]. That section 3225 of the Revised Statutes of the United States, as amended, is re-enacted without change as follows:

**Section 3225 of the Revised Statutes.**

**8047** "Sec. 3225. When a second assessment is made in case of any list, statement, or return, which in the opinion of the collector or deputy collector was false or fraudulent, or contained any understatement or undervaluation, such assessment shall not be remitted, nor shall taxes collected under such assessment be refunded, or paid back, or recovered by any suit, unless it is proved that such list, statement, or return was not willfully false or fraudulent and did not contain any willful understatement or undervaluation."

**Limitations Upon Suits and Prosecutions.**

**8048** (Law.) Sec. 1318 [of the Revenue Act of 1921]. That section 3226 of the Revised Statutes is amended to read as follows:

**Section 3226 of the Revised Statutes.**

**8049** "Sec. 3226. No suit or proceeding shall be maintained in any court for the recovery of any internal-revenue tax alleged to have been erroneously or illegally assessed or collected, or of any penalty claimed to have been collected without authority, or of any sum alleged to have been excessive or in any manner wrongfully collected, until a claim for refund or credit has been duly filed with the Commissioner of Internal Revenue, according to the provisions of law in that regard, and the regulations of the Secretary of the Treasury established in pursuance thereof. No such suit or proceeding shall be begun before the expiration of six months from the date of filing such claim unless the Commissioner renders a decision thereon within that time, nor after the expiration of five years from the date of the payment of such tax, penalty, or sum."

**8050** This section shall not affect any suit or proceeding instituted prior to the passage of this Act, but shall apply to all suits and proceedings instituted after the passage of this Act, whether or not barred by prior Acts of Congress.

### Section 3227 of the Revised Statutes Repealed.

**8051** (Law.) Sec. 1319 [of the Revenue Act of 1921]. That section 3227 of the Revised Statutes is hereby repealed but such repeal shall not affect any suit or proceeding instituted prior to the passage of this Act.

### Five-Year Limitation on Suits.

**8052** (Law.) Sec. 1320 [of the Revenue Act of 1921]. That no suit or proceeding for the collection of any internal revenue tax shall be begun after the expiration of five years from the time such tax was due, except in the case of fraud with intent to evade tax, or willful attempt in any manner to defeat or evade tax. This section shall not apply to suits or proceedings for the collection of taxes under section 250 [Income and Excess-Profits Taxes] of this Act, nor to suits or proceedings begun at the time of the passage of this Act.

### Limitation on Criminal Prosecutions.

**8053** (Law.) Sec. 1321 [of the Revenue Act of 1921]. (a) That the Act entitled "An Act to limit the time within which prosecutions may be instituted against persons charged with violating internal-revenue laws" approved July 5, 1884, is amended to read as follows:

**8054** "That no person shall be prosecuted, tried, or punished for any of the various offenses arising under the internal-revenue laws of the United States unless the indictment is found or the information instituted within three years next after the commission of the offense: *Provided*, That the time during which the person committing the offense is absent from the district wherein the same is committed shall not be taken as any part of the time limited by law for the commencement of such proceedings: *Provided further*, That the provisions of this Act shall not apply to offenses committed prior to its passage: *Provided further*, That where a complaint shall be instituted before a commissioner of the United States within the period above limited, the time shall be extended until the discharge of the grand jury at its next session within the district: *And provided further*, That this Act shall not apply to offenses committed by officers of the United States."

**8055** (b) Any prosecution or proceeding under an indictment found or information instituted prior to the passage of this Act shall not be affected in any manner by this amendment, but such prosecution or proceeding shall be subject to the limitations imposed by law prior to the passage of this Act.

### Limitation on Claims for Refund or Credit.

**8056** (Law.) Sec. 1316 [of the Revenue Act of 1921]. That section 3228 of the Revised Statutes is amended to read as follows:



**ADMISSIONS AND DUES TAXES.—RUNNING TABLE OF CONTENTS.****Rulings, Regulations, Opinions and Decisions  
under the****Admissions and Dues Tax Law Provisions of the Revenue Act of 1921.****Giving Treasury Decision Number or other Designation, Date of Issue, and General  
Subject Content.**

<b>T. D.</b>	<b>Date</b>	<b>Subject</b>	<b>Paragraph</b>
<b>Law Provisions.....</b>			<b>6500</b>
<b>Reg. 43 Pt. 1.</b>	<b>Feb. 15, 1922</b>	<b>Admissions regulations as amended to January 1, 1923. (Fully indexed on the blue sheets following.)...Page 1319</b>	
<b>Reg. 43 Pt. 2.</b>	<b>Apr. 13, "</b>	<b>Dues regulations as amended to January 1, 1923. (Fully indexed on the blue sheets following.)..... 6513</b>	
<b>The matters listed above are indexed.</b>			
<b>3431</b>	<b>Jan. 22, 1923</b>	<b>Admissions: Skating rinks: Court decision, 1918 Act..</b>	<b>6837</b>
<b>3439</b>	<b>Feb. 12, "</b>	<b>Dues: Arts. 9, 10, 11, and 12, Reg. 43, Part 2, amended..</b>	<b>6841</b>

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**E511** It is the intent of the statute that charitable bequests shall not be taxed. By its regulation of the incidence of the tax, New York does in fact diminish in favor of the United States what the charities receive; but it must be wrong for the executive departments of the United States to use the rule of incidence, which is of state creation, to increase its own exactions.

**E512** As Holmes, J. remarked in the New York Trust Co. case, *supra*, "Upon this point a page of history is worth a volume of logic." History, so far as we can discover, shows no other instance of attempting to measure a tax *pro tanto* by itself. As Hand, J., said in the court below, this theory departs from long established practice and from the usage if not the law of never regarding the incidence of a tax in the levying of a tax.

**E513** So far as authority goes, *Dugan vs. Miles*, 276 Fed., 401, is the only decision suggested on this branch of the statute. The facts in that litigation were legally identical with those at bar; yet it is true that the doctrine here contended for by the Treasury was not alluded to by the experienced and able Judge who wrote opinion, although his result is consistent only with the methods pursued by these defendants-in-error. The inference is that neither the Judge nor counsel on either side thought of such a theory—which does not seem to us surprising.

**E514** Being of opinion, therefore, that the scheme of taxation insisted on by plaintiff-in-error is unjust, opposed to long-established practice and the spirit of the statute, that it is not required by the language of the act, and tends to confusion taking the country over—the judgment below [¶306] should be and is affirmed, with costs.





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## TELEGRAPH AND TELEPHONE REGULATIONS.

**5576** (2) [See Sec. 1302, ¶8014.]

**5577** (3) Section 3176 of the Revised Statutes [¶8073], as amended and reenacted, provides that in case of any failure to make and file a return within the prescribed time there shall be added to the tax 25 per cent of its amount.

**5578** (4) Section 3176 of the Revised Statutes [¶8073], as amended and reenacted, further provides that in case a false or fraudulent return is willfully made there shall be added to the tax 50 per cent of its amount.

## AUTHORITY FOR REGULATIONS.

**5579** Art. 42. **Promulgation of regulations.**—In pursuance of this provision of the act [¶8009] the foregoing regulations are hereby made and promulgated and all rulings inconsistent with them are hereby revoked.

D. H. BLAIR,

*Commissioner of Internal Revenue.*

Approved February 15, 1922 [Released for publication February 28, 1922.]

A. W. MELLON,

*Secretary of the Treasury.*





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## EXCISE TAXES REGULATIONS.

Getting the bill of lading stands no differently from putting the goods on board ship. Neither does it matter that the title was in Scholtz & Co. and that theoretically they might change their mind and retain the bats and balls for their own use. There was not the slightest probability of any such change and it did not occur. The purchase by Scholtz & Co. was solely for the purposes of Delgado & Cia. and for their account and risk. Theoretical possibilities may be left out of account. In *Railroad Commission of Louisiana v. Texas & Pacific Ry. Co.*, 229 U. S. 336, the consignees might have retained the goods at New Orleans instead of shipping them abroad. The fact that they came to New Orleans by rail from another place in the State made no difference. The same principle was applied in *Texas & New Orleans R. R. Co. v. Sabine Tram Co.*, 227 U. S. 111, 123. The overt act of delivering the goods to the carrier marks the point of distinction between this case and *Cornell v. Coyne*, 192 U. S. 418. To put it at any later point would fail to give to exports the liberal protection that hitherto they have received; of which an example may be seen in *Thames & Mersey Marine Ins. Co., Ltd. v. United States*, 237 U. S. 19.

Judgment reversed.

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**The matters listed above are indexed.****The regulations, rulings, etc., listed below are those issued during 1923.**

<b>Decision</b>	Jan. 8, 1923	Central Union Trust Co. vs. Edwards, C. C. of A., Second Circuit. Affirming decision of May 25, 1922 above	<b>3171</b>
<b>3438</b>	Feb. 10, "	T. D. designation for the Central Union Trust Company vs. Edwards decision, listed under Jan. 8, 1923 above.	

**Insert this sheet immediately before the blue Capital Stock Tax Index.**





## SALES (EXCISE) TAXES.—RUNNING TABLE OF CONTENTS.

## Rulings, Regulations, Opinions and Decisions

under the

## Sales and Excise Taxes Law Provisions.

Giving Treasury Decision Number or other Designation, General Subject Content,  
Date of Issue, and Paragraph Reference.

T. D.	Date	Subject	Paragraph
Law Provisions.....			4500
Reg. 47	Jan. 6, 1922	Manufacturer's and producer's excise taxes regulations as amended to January 1, 1923. (Indexed on the blue sheets following).....	Page 910
Reg. 48	Jan. 12, "	Works of art and jewelry taxes regulations. (See exhaustive Table of Contents on page 934.).....	Page 934
Decision	May 16, "	Malley vs. Walter Baker & Co., Ltd., 1918 Act. Sweet chocolate as candy. (See note at ¶4634.)	

*Listed below are matters issued during 1923.*

Decision	Feb. 7, 1923	Klepper vs. Carter, 9th. C. C. of A.—One who installs a body on a chassis, acquired from different sources, and sells the combination at retail as an automobile truck is the manufacturer thereof.....	4758
3443	" 24, "	(This T. D. reproduces, merely, the decision in Klepper vs. Carter, ¶4758 above.)	
3469	Apr. 21, "	Art. 27, Reg. 47 amended.—Smokers' articles: humidors.	4766
Decision	" 23, "	U. S. Supreme Court.—Spalding vs. Edwards.—Exports under the 1917 Act.....	4767

Insert this page immediately before the blue "Sales Taxes" index.





**Perpetual Check List**  
**Supplementary Rulings Reprinted from the Internal Revenue Bulletins.**

The Supplementary Rulings are printed on the pages immediately preceding.

**The Foreword to the Supplementary Rulings should be read.**

**Key.**—The word “none,” in the column headed “Last Ruling,” signifies in each case that there are no special rulings bearing on the particular Article of Regulations 45 (1918 Act) or of Regulations 62 (1921 Act).

The numeral, in each case, shows *how many* serially numbered special rulings bearing on the particular Article have been reproduced and indicates *the last* serial number of the group. These serial numbers appear in bold face type at the *end* of the special rulings themselves, within the Supplement.

**Caution.**—To the extent of the imposition of the excess-profits tax for 1921, the 1918 and 1921 laws are identical, except that domestic corporations entitled to the benefits of Section 262 of the 1921 Act (§1083) are grouped with foreign corporations for the purposes of the 1921 excess-profits tax. To much the same extent, with like qualifications, the provisions of Regulations 62 (1921 Act) are essentially identical (there are frequent verbal changes) to the provisions of Regulations 45 (1918 Act). The numbering of the Articles of Regulations 62 (1921 Act) is the same as that of the respective corresponding Articles of Regulations 45 (1918 Act), except as noted below. It follows then, that, except as noted below, for the purposes of the Supplementary Bulletin Rulings, the Article reference number is the same under either Act.

Reg. 62 (1921 Act)	Reg. 45 (1918 Act)
No corresponding Article.....	to Article 712
Article 712 is the same as, therefore refer to, Article 713	
“ 713 “ “ “ “ “ “ “ “ “ “	714
“ 714 “ “ “ “ “ “ “ “ “ “	715
“ 715 “ “ “ “ “ “ “ “ “ “	716
No corresponding Article.....	to Article 717
Article 716 is the same as, therefore refer to, Article 719	
“ 717 “ “ “ “ “ “ “ “ “ “	718
“ 718 “ “ “ “ “ “ “ “ “ “	720
No corresponding Article.....	to Article 869
Article 869 is the same as, therefore refer to, Article 870	
“ 870 “ “ “ “ “ “ “ “ “ “	871

**Otherwise**

Art. of Reg. 62 is same as, therefore refer to, same numbered Art. of Reg. 45  
*(The list is always up-to-date.)*

Law Section	Article Number	Last Ruling	Law Section	Article Number	Last Ruling
300.....	701.....	None	302.....	732.....	1
301.....	711.....	1	“.....	733.....	None
“.....	712.....	None	303.....	741.....	2
“.....	713.....	None	“.....	742.....	None
“.....	714.....	11	“.....	743.....	None
“.....	715.....	2	304.....	751.....	None
“.....	716.....	None	“.....	752.....	1
“.....	717.....	None	“.....	753.....	None
“.....	718.....	None	305.....	761.....	None
“.....	719.....	1	310.....	771.....	1
“.....	720.....	None	311.....	781.....	3
302.....	731.....	1	“.....	782.....	None

(Over.)

Insert immediately preceding blue page 401.

Law Section	Article Number	Last Ruling
311.....	783.....	1
".....	784.....	None
".....	785.....	None
312.....	791.....	3
320.....	801.....	1
".....	802.....	1
325.....	811.....	2
".....	812.....	3
".....	813.....	10
".....	814.....	None
".....	815.....	9
".....	816.....	1
".....	817.....	1
".....	818.....	3
326.....	831.....	42
".....	832.....	None
".....	833.....	5
".....	834.....	1
".....	835.....	3
".....	836.....	17
".....	837.....	5
".....	838.....	10
".....	839.....	4
".....	840.....	10
".....	841.....	5
".....	842.....	None
".....	843.....	2
".....	844.....	1
".....	845.....	10
".....	845A.....	(See 845)
".....	846.....	4
".....	847.....	None
".....	848.....	None
".....	849.....	None
".....	850.....	2
".....	851.....	6
".....	852.....	1
".....	853.....	1

Law Section	Article Number	Last Ruling
326.....	854.....	2
".....	855.....	1
".....	856.....	None
".....	857.....	6
".....	858.....	10
".....	859.....	2
".....	860.....	1
".....	861.....	None
".....	862.....	3
".....	863.....	None
".....	864.....	None
".....	865.....	None
".....	866.....	None
".....	867.....	None
".....	868.....	None
".....	869.....	1
".....	870.....	None
".....	871.....	1
327.....	901.....	30
328.....	911.....	2
".....	912.....	3
".....	913.....	1
".....	914.....	2
330.....	931.....	4
".....	932.....	1
".....	933.....	7
".....	934.....	None
331.....	941.....	18
335.....	951.....	None
".....	952.....	1
".....	953.....	None
".....	954.....	None
".....	955.....	None
336.....	961.....	None
".....	962.....	None
337.....	971.....	2
".....	972.....	None
338.....	981.....	None

Every Article of Regulations 45 (1918 Act) and of Regulations 62 (1921 Act) bearing specifically on the war-profits and excess-profits tax is listed in the foregoing table. The first Article is 701.

Missing Article numbers such as 702 to 710 have not yet been used.

*The last Bulletin from which rulings have been reproduced hereinbefore and as listed above is*

VOLUME II (1923), No. 5.

*Later Bulletins, since issued (if any), contain no rulings bearing on the 1918 or 1921 excess-profits tax laws.*

Insert this page to face blue page 401.



### Upon this evidence the Committee found:

That there was a substantial change of beneficial interest in the property when turned over to the Z Company is clear. The creditors of the Y Company as above indicated, purchased the property at the receiver's sale at a price less than their claims, and when the creditors turned the property over to the Z Company in consideration for the assumption by the latter of the debts owed the creditors of the Y Company, the cost of the property to the Z Company thereby became established. The Committee can not ignore the fact convincingly shown by the record that the parties to this transaction were dealing at arms' length; that the three banks to which was owed 93.70 per cent of the indebtedness assumed by the Z Company did not become stockholders of that company; and that the conduct of the business by the receiver whereby a loss of .08x dollars or .1x dollars was incurred tended materially to decrease the actual value of the property for the purpose of sale between a willing seller and a willing buyer.

\* \* \* In view of the two intermediate transactions between ownership of the property by the Y Company and acquisition by the Z Company, the Committee is of the opinion that the Bureau is precluded by article 63 of Regulations 41, as construed in Solicitor's Memorandum 551 (not published), and by article 836 of Regulations 45, from ascribing to this property for the purpose of computing statutory invested capital a value in excess of its actual cost to the Z Company, and it is recommended that the claim for paid-in surplus for 1917 and 1918 be denied.

It is believed that a careful consideration of the principles involved in these two cases will furnish a satisfactory basis for a determination of the question whether property purchased at a receiver's sale and paid into a corporation is to be deemed to have been acquired at a bargain price and the excess value for that reason excluded from the capital.

Where the assets of a corporation are purchased by its creditors (bondholders or general creditors) at a receiver's sale and are thereafter conveyed by the creditors to a new corporation of which they are the stockholders for a financial consideration, or in consideration for all or substantially all of its capital stock, as in the case cited in T. B. R. 32, the price at which the property is purchased by the creditors is usually nominal, the true cost of the assets to the creditors being the amount of their credits, and in the conveyance to the new corporation there is no substantial change in beneficial ownership but only in the form of ownership. The element of bargaining does not enter into the transaction and if the value of the assets which can be clearly and definitely established is substantially in excess of the consideration paid therefor by the corporation, or of the par value of the stock issued therefor, a paid-in surplus in the amount of such excess may be allowed. If, on the other hand, the property is conveyed by creditors to a corporation in which they do not hold the capital stock or a substantial part of it, as in the case considered in T. B. M. 49, a reasonable regard for human nature compels the conclusion that the property is not conveyed for a consideration substantially less than that for which it could be sold in the market and that the price or the consideration paid therefor fixes the cost of the assets and, therefore, the value to the corporation for the purpose of computing its invested capital.

Whether or not the creditor were stockholders of the old corporation appears to have little or no bearing upon the rules just stated, but if the transaction under consideration took place subsequent to March 3, 1917, the consideration of whether or not the creditor purchasers were also the stockholders of the old corporation becomes material, since, if they were, the transaction would ordinarily constitute a reorganization and the limitation imposed by section 331 of the Act of February 24, 1919, would apply.

In the light of these principles your questions are answered specifically as follows, the substance of the questions being incorporated in the answers to avoid any misunderstanding as to what factors are considered material to be considered:

(a) When the purchasers at a receiver's sale are creditors of the old corporation but are not stockholders in either the old or the new corporation, the price paid for the assets by the new corporation fixes the value of the assets for the purpose of computing its invested capital and no paid-in surplus can be allowed.

(b) When the purchasers are both creditors and the stockholders of both corporations and a value for the assets clearly and substantially in excess of the cash or par value of the stock paid therefor by the corporation, can be definitely and accurately established, a paid-in surplus may be allowed. If, however, the transaction occurred after March 3, 1917, the transaction will ordinarily be held to constitute a reorganization and the limitation imposed by section 331 of the Act of February 24, 1919, will apply.

(c) When the purchasers are the stockholders of both the old and the new corporations but are not creditors of the old corporation, there is no substantial change in the beneficial interests and the cash or other consideration received for the assets from the new corporation does not necessarily measure the value of the assets, and the same rule applies as in case (b). If the transaction occurred subsequent to March 3, 1917, the transaction would ordinarily constitute a reorganization and be governed by section 331 of the Revenue Act of February 24, 1919.

(d) When the purchasers are composed in part of creditors of the old corporation who are not stockholders and in part of stockholders of the new and old corporations, each case must be determined upon its own particular facts in accordance with the principles above stated. If the number of creditor stockholders common to both corporations is sufficiently large so that there is no substantial change of beneficial ownership, the case will fall within the rule laid down in case (b). If on the other hand, a considerable number of the purchasers are not stockholders of the new corporation, it is not to be supposed that they would consent to a sale of the assets for a price materially less than their fair value and, therefore, the price or consideration paid would determine the value of the assets for the purpose of computing invested capital and no paid-in surplus can be allowed.



## EXCESS PROFITS TAX.—RUNNING TABLE OF CONTENTS.

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under the

## War-Profits and Excess-Profits Tax Laws.

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Date of Issue, and Paragraph Reference.

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1918 Law Provisions.....			500
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3220	Aug. 26, "	Amended returns required within 90 days when inflated values have been used in determining invested capital	865
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Special	July 6, "	Explanation of the foregoing.....	879
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Decision	Nov. 9, 1920	DeLaski & Thropp Circular Woven Tire Co. vs. Iredell, District Court decision, Act of 1917. A corporation whose entire income is derived from royalties on patents in which it has no investment is entitled to assessment under Section 209 as being engaged in a trade or business having no invested capital or not more than a nominal capital.....	913
Decision	Apr. 19, 1921	Lincoln Chemical Co. vs. Edwards. District Court decision, 1917 Act. Additions to surplus account: Earned surplus expended in developing and improving a secret process, or used to repay borrowed money so expended.....	926
(Above affirmed, ¶1300.)			
Decision	Dec. 15, "	Cartier-Holland Lumber Co. vs. Doyle. U. S. Circuit Court of Appeals decision, 1917 Act. Borrowed capital in relation to the "no invested capital or not more than a nominal capital" provision of Sec. 209 of the 1917 Act.....	943
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The matters listed above are fully indexed on the blue index following page 400.

For running table of contents of matters relating to the 1921 Excess Profits Tax Law specially, and to other matters issued since the passage of that Act, see  
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### War-Profits and Excess-Profits Tax Laws.

Giving Treasury Decision Number or other Designation, General Subject Content,  
Date of Issue, and Paragraph Reference.

T. D.	Date	Subject	Paragraph
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3367	July 10, 1922	Art. 836, Reg. 62, amended.—Tangible property paid in; value in excess of par value of stock.	1265
Special	Jan. 16, "	Allocation of tax: partnerships and corporations in consolidated cases under 1917-1921 Acts.	1266
Special	April, "	Consolidated returns for 1917 (A. R. R. 855).	1273
Special	June, "	Consolidated returns for 1917 (A. R. R. 942).	1274
3389	Aug. 24, "	Arts. 77 and 78, Reg. 41 (1917 Act) amended.—Consolidated returns, 1917.	1289

The matters listed above are fully indexed on the blue index beginning opposite.

Decision	Jan. 2, 1923	Greenport Basin and Construction Co. vs. U. S., 1917 Act.—Application of the deduction in the computation of the tax.	1297
3129	" 19, "	T. D. designation for the Greenport Basin and Construction Co. vs. U. S. decision (see Jan. 2, 1923, above) reported at ¶1297.	
Decision	Feb. 5, "	Lincoln Chemical Co. vs. Edwards, 2d. C. C. of A. decision, 1917 Act.—Additions to surplus account: Earned surplus expended in developing and improving a secret process, or used to repay borrowed money so expended.	1300
3458	Apr. 4, "	(This T. D. reproduces, merely, the decision in Lincoln Chemical Company case, ¶1300 above.)	

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754	Notification by lessor where lessee is responsible for collection of the tax—Not reproduced. See ¶6827.	
755	Affidavit claiming exemption: admissions. Not reproduced. See ¶6777.	
755A	Notification by Collector of allowance or disallowance of claim for exemption. Not reproduced. See ¶6779.	
<b>SPECIAL TAXES.</b>		
11	Special-tax return.....	1507
11A	Brokers' special tax return.....	1509
725	Receipt form for tax on pleasure boats—Not reproduced. See ¶7634.	
732	Return for special tax on pleasure boats and automobiles.....	1511
<b>CAPITAL STOCK TAX.</b>		
707	Annual return of domestic corporations.....	603
708	Annual return of foreign corporations.....	607





TREASURY DEPARTMENT  
 INTERNAL REVENUE SERVICE  
 Form 732.—Revised March, 1922

# **SPECIAL-TAX RETURN** **AUTOMOBILES FOR HIRE OR USE OF BOATS** (See instructions on back.)

NAME \_\_\_\_\_ (Give name of taxpayer, to be followed by trade name if desired.)  
 ADDRESS \_\_\_\_\_ (Number of building, or street, or other exact location.)  
 SPECIAL TAX ON \_\_\_\_\_ (City or town.) \_\_\_\_\_ (County.) \_\_\_\_\_ (State.)  
 \_\_\_\_\_ (State whether automobile or boat.) \_\_\_\_\_ FOR PERIOD FROM \_\_\_\_\_ TO JUNE 30, 19\_\_\_\_  
 \_\_\_\_\_ (Entered on record in.)  
 \_\_\_\_\_ (Stamp number.)  
 \_\_\_\_\_ (Date of issue.)

## **AUTOMOBILES**

(A separate return is required for each automobile or boat.)

If in the business of operating or renting passenger automobiles for hire, give make, model, engine number, and seating capacity of such automobile in proper spaces provided below:

MAKE \_\_\_\_\_

MODEL \_\_\_\_\_

ENGINE NUMBER \_\_\_\_\_

SEATING CAPACITY \_\_\_\_\_

Give below name and residence of each person interested in the business. If a corporation, give name, residence, and title of each officer.

## **NAME**

## **RESIDENCE**

Sworn to and subscribed before me this \_\_\_\_\_

day of \_\_\_\_\_, 192\_\_\_\_

(Signed)

CASH:	DRAFT:
CHECK:	M. O.:

(Official title or signature of witnesses.)

Make remittance payable to "Collector of Internal Revenue."

(State whether individual owner, lessee, member of firm, or if officer of corporation give title.)

This return, properly executed, should be forwarded to the Collector of Internal Revenue at \_\_\_\_\_

with the amount of the tax, within the month in which the liability is incurred.

## SPECIAL TAXES ON OCCUPATIONS REGULATIONS.

## INSTRUCTIONS

## PLEASURE BOATS

1. **WHAT IS TAXED.**—Subject to exemptions noted hereunder, a special tax is imposed upon the use of yachts, pleasure boats, power boats, motor boats with fixed engines, and sailing boats, of over five net tons, length over 32 feet, at the following rates:

- (a) Over five net tons, length over 32 feet and not over 50 feet.....\$1.00 each foot
- (b) Over five net tons, length over 50 feet and not over 100 feet.....\$2.00 each foot
- (c) Over five net tons, length over 100 feet.....\$4.00 each foot

2. **EXEMPTIONS.**—The law exempts from tax—

- (a) Boats used *exclusively* for trade. ("Trade" is held to be any serious activity which constitutes the means of livelihood of the owner, lessee, or charterer.)
- (b) Boats used *exclusively* for fishing. (This refers to commercial fishing and not fishing for pleasure.)
- (c) Boats used *exclusively* for national defense.
- (d) Boats built according to plans and specifications approved by the Navy Department.
- (e) Boats used without profit by benevolent, charitable, or religious organizations *exclusively* for furnishing aid, comfort, or relief to seamen.

3. **PERSONS LIABLE FOR RETURN AND PAYMENT OF TAX.**—The owner, lessee, or charterer of every boat described in par. 1 is required to file return, irrespective of whether its use is exempt from the tax under par. 2, and, unless the boat is exempt, is also required to pay the tax (see also par. 4(d) below). No return is required on boats falling below the tonnage and footage specifications mentioned in par. 1.

4. **HOW TO ESTIMATE NET TONNAGE.**—To estimate roughly the net tonnage of a vessel the following rules may be used:

- (a) By the word "ton" is meant 100 cubic feet of space.
- (b) Multiply the extreme length of the vessel by the extreme breadth and that product by the depth from the underside of the deck to the frame in the hold taken amidships. The result obtained should be multiplied by six-tenths. To this result should be added the cubical contents of any closed-in structure above the upper deck. The sum should be divided by 100, which will give the approximate gross tonnage of the boat.
- (c) From this gross tonnage may be deducted all spaces used *exclusively* in connection with the navigation of the boat or for the exclusive use of the crew, such as a reasonable amount for machinery space, space for officers and crew but not for passengers (who include all persons not actual members of the crew), storage of sails, navigation instruments, boatswain's stores, etc. The result will be the approximate net tonnage of the boat.
- (d) If the net tonnage estimated is more than four net tons, and the length over 32 feet, application should be made to the nearest customs officer for official measurement. If an official measurement is not completed before the date on which a return is required, a return should be rendered; and if the estimate of net tonnage, made as above directed, is over five net tons, the tax should be paid. If the official measurement should later show that no tax was due, a claim should be made for the refund of the tax.

5. **HOW TO ASCERTAIN THE OVER-ALL LENGTH.**—Over-all length is defined as the extreme length of the structure, i. e., from the forward side of the stem outside the planking or plating to the aftermost side of the stern planking or plating, whether above or below the water line. The measurement should be to the outside of any planking or plating extending above the deck, constituting bulwarks, and to the outside of any forecastle deck, quarter deck, or poop deck extending beyond the main deck. The length should be taken in a straight line, excluding any sheer there may be to the deck.

6. **HOW TO COMPUTE TAX.**—In the case of a boat over five net tons, multiply the rate of the class in which the boat is included by the number representing the length over all in full feet. For example, a boat 49.5 feet in length is taxable at the rate of \$1 for each foot, or \$49; a boat 50.5 feet in length is in the same class and taxable at \$1 per foot, or \$50.

## AUTOMOBILES

7. **PERSONS LIABLE FOR RETURN AND PAYMENT OF TAX.**—Persons carrying on the business of operating or renting passenger automobiles for hire are required to file return and pay special tax on each automobile as follows:

	Annual rate.	Monthly rate.
Seating capacity over 2 but not over 7.....	\$10	\$0.83½
Seating capacity more than 7.....	\$20	\$1.66½

## GENERAL

8. **WHEN RETURN AND PAYMENT OF TAX MUST BE MADE.**—These taxes become due on the first day of July in each year, or on commencing the business on which a tax is imposed or placing a boat in use. In the former case the tax shall be reckoned for one year and in the latter case it shall be reckoned proportionately from the first day of the month in which the liability to special tax commenced to the first day of July following. Returns with proper amount of tax due must be filed with the collector not later than the last day of the month in which special tax liability commenced. A separate return must be filed for each automobile operated or rented for hire, and for each boat whether or not exempt from tax. Where exemption is claimed in the case of a boat, the return should be filed and the notation "exemption claimed" made across the face of the form. If exemption is allowed, the collector will issue an exemption certificate.

9. If tax liability, as shown by the return, is more than \$10, applicant must appear in person before an officer qualified to administer oaths and swear to the correctness of the information given on the application. If the tax is \$10 or less, return may be signed or acknowledged before two witnesses, who will affix their signatures.

Follow instructions carefully and file promptly in order to avoid penalties imposed for delinquency in filing return and paying tax, or making false or fraudulent return.

GOVERNMENT PRINTING OFFICE

2-8593



## STAMP TAXES.—RUNNING TABLE OF CONTENTS.

## Rulings, Regulations, Opinion and Decisions

under the

Stamp Tax Law.

Giving Treasury Decision Number or other Designation, General Subject Content,  
Date of Issue, and Paragraph Reference.

T. D.	Date	Subject	Paragraph
Law Provisions.....			3500
Reg. 40	July 8, 1922	Comprehensive regulations relating to stamp tax on issues, sales and transfers of stock and sales of products for future delivery. (See exhaustive Table of Contents beginning on page 709.)	
Reg. 55	June 12, 1922	Comprehensive regulations relating to stamp taxes on documents, fully indexed on the blue-page index at the back of this Stamp Taxes division.....	3743
O. D. 83	March, 1921	Taxable and tax-free issues upon a merger of corporations.	3994
Decision	May 31, "	Marconi Wireless Telegraph Co. vs. Duffy. District Court decision, 1918 Act. Transfer of right to receive stock.....	3998
Special	Feb., "	Transfer of stock from trustee to substituted trustee, when such transfer results wholly from operation of law.....	4000
Special	May 4, "	Transfer of stock to substituted trustee under the Massachusetts law.....	4001
Special	Mar. 15, "	Nominal transfer of title to stock on death of trustee to surviving trustee or trustees.....	4002
Special	Apr. 19, "	Use of rubber stamps on certificates in case of transfers of stock to broker for sale and from broker to purchasing customer.....	4003
Special	Sept. 20, "	Drafts payable in terms of foreign currency, accepted or delivered within U. S.....	4004
Special	Nov. 4, "	Trade acceptance given in settlement of balance due on open export account is not exempt, as it is not incident to the process of export.....	4005
Special	Mar. 31, "	Extension or renewal of promissory note by extension of mortgage by which secured.....	4008
Special	Apr. 13, "	Drafts covering bunker coal supplied in this country to foreign steamship company.....	4009
Decision	July 14, "	Fidelity Trust Co. vs. Lederer. District Court decision, 1918 Act. Trust certificates issued under Pennsylvania plan held to be taxable as "Certificates of Indebtedness.".....	4010
Special	Jan. 26, 1922	Reliance of original-issue agents on statement of officials of corporation as to "actual value" of its non-par value stock.....	4016
Special	Jan. 26, "	Original issue tax liability on certificate representing more than one share having actual value of less than \$100.....	4019
Special	Feb. 3, "	Transfer of stock owned by a partnership to the individual members thereof.....	4020
Special	May 27, "	Stamps of large denominations in proper aggregate amount may be affixed to permanent corporation record accompanying proxies in lieu of separate stamps to the respective proxies.....	4021
Special	Nov. 4, 1921	Transfer of stock standing in name of brokerage firm, to and into name of successor firm, is taxable.....	4024
Special	Aug. 16, 1922	Transfer of stock from banking institution to its nominee is taxable.....	4026

The matters listed above are indexed.

# STA P TAXES.—RUNNING TABLE OF CONTENTS.

## Rulings, Regulations, Opinions and Decisions

under the

Stamp Tax Law.

Issued herein since January 1, 1923.

Giving Treasury Decision Number or other Designation, General Subject Content, Date of Issue, and Paragraph Reference.

The matters listed below are not indexed.

T. D.	Date	Subject	Paragraph
3417	Dec. 16, 1922	Fidelity Trust Co. vs. Lederer. District Court Decision, 1918 Act. Trust Certificates issued under Pennsylvania Plan held to be taxable as "Certificates of Indebtedness".....	4027
Decision	Aug 18, "	Haverty Furniture Co. vs. U. S. District Court decision, 1918 Act. Installment purchase agreement contracts even though embodying an "agreement to pay" in terms, are not per se promissory notes, and so, are not taxable as such.....	4028
Special	Jan. 31, 1923	Instances of nontaxable transfers from trustee to substituted trustee of legal title to stock because resulting wholly from operation of law, under the laws of New York.....	4032
3446	Mar. 1, 1923	Art. 13, Reg. 40, amended.—Sales and transfers of stock not subject to tax.....	4034
3466	Apr. 13, 1923	Art. 5(g), Reg. 40, amended.—Original stock issues not subject to tax.....	4040

Insert this sheet immediately before the blue Stamp Tax index.



## STAMP TAX REGULATIONS.

"We hereby certify that the transfer of.....shares of the within stock to.....has been made pursuant to a 'call,' and that the Federal stock transfer stamps for the transaction are affixed to such 'call,' which is in our possession.

.....  
(Seller sign here.)"

**4039** "(p) Where, under Paragraph (k) of this Article, a certificate of  
3629 stock, standing either in the name of the owner or any other person, has been delivered by the owner thereof to a broker for sale, and subsequently, under paragraph (l) of this Article, such certificate has been delivered by a broker to his customer for whom it is purchased and the tax has been paid upon the delivery of such certificate from the seller's broker to the buyer's broker, the transfer of such certificate of stock into the name of the buyer is not subject to tax, provided, that either requisite stamps shall have been affixed to the certificate of stock upon its delivery to the buyer's broker, or the memorandum of sale evidencing the transaction between the seller's broker and the buyer's broker, with the requisite stamps affixed thereto, shall have been attached to such certificate at such time and presented to the transfer agent at the time such certificate is surrendered for transfer. The old certificate, together with the memorandum of sale, if used, shall be preserved by such transfer agent for the inspection of the revenue officer."

(T. D. 3446, signed by Commissioner D. H. Blair, and dated March 1, 1923.)

\_\_\_\_\_  
(T. D. 3466.)

**4040** Issues of Stock: Article 5(g) of Regulations 40, 1922 Edition,  
3582 Amended.—Article 5(g) of Regulations 40, 1922 Edition, is hereby amended to read as follows:

"(g) The issue of certificates of stock in exchange for outstanding certificates, for the purpose of splitting up a certificate for a number of shares into two or more certificates for a smaller number of shares of the same kind of stock, where there is no change in ownership or in the total amount of such stock issued, is not subject to tax." (T. D. 3466, signed by Commissioner D. H. Blair, and dated April 13, 1923.)





## Perpetual Check List

Supplementary Rulings Reprinted from the Internal Revenue Bulletins.

The Supplementary Rulings are printed on the pages immediately preceding.

The Foreword to the Supplementary Rulings should be read.

**Key.**—The word “none,” in the column headed “Last Ruling,” signifies in each case that there are no special rulings bearing on the particular Article of Regulations 45 (1918 Act) or of Regulations 62 (1921 Act).

The numeral, in each case, shows *how many* serially numbered special rulings bearing on the particular Article have been reproduced and indicates *the last* serial number of the group. These serial numbers appear in bold face type at the *end* of the special rulings themselves, within the Supplement.

**Caution.**—To the extent of the imposition of the excess-profits tax for 1921, the 1918 and 1921 laws are identical, except that domestic corporations entitled to the benefits of Section 262 of the 1921 Act (§1083) are grouped with foreign corporations for the purposes of the 1921 excess-profits tax. To much the same extent, with like qualifications, the provisions of Regulations 62 (1921 Act) are essentially identical (there are frequent verbal changes) to the provisions of Regulations 45 (1918 Act). The numbering of the Articles of Regulations 62 (1921 Act) is the same as that of the respective corresponding Articles of Regulations 45 (1918 Act), except as noted below. It follows then, that, except as noted below, for the purposes of the Supplementary Bulletin Rulings, the Article reference number is the same under either Act.

Reg. 62 (1921 Act)	Reg. 45 (1918 Act)
No corresponding Article.....	to Article 712
Article 712 is the same as, therefore refer to, Article	713
“ 713 “ “ “ “ “ “ “ “ “	714
“ 714 “ “ “ “ “ “ “ “ “	715
“ 715 “ “ “ “ “ “ “ “ “	716
No corresponding Article.....	to Article 717
Article 716 is the same as, therefore refer to, Article	719
“ 717 “ “ “ “ “ “ “ “ “	718
“ 718 “ “ “ “ “ “ “ “ “	720
No corresponding Article.....	to Article 869
Article 869 is the same as, therefore refer to, Article	870
870 “ “ “ “ “ “ “ “ “	871

Otherwise

Art. of Reg. 62 is same as, therefore refer to, same numbered Art. of Reg. 45  
(The list is always up-to-date.)

Law Section	Article Number	Last Ruling	Law Section	Article Number	Last Ruling
300	701	None	302	732	1
301	711	1	"	733	None
"	712	None	303	741	2
"	713	None	"	742	None
"	714	11	"	743	None
"	715	2	304	751	None
"	716	None	"	752	1
"	717	None	"	753	None
"	718	None	305	761	None
"	719	1	310	771	1
"	720	None	311	781	3
302	731	1	"	782	None

(Over.)

Insert immediately preceding blue page 401.

Law Section	Article Number	Last Ruling	Law Section	Article Number	Last Ruling
311.....	783.....	1	326.....	854.....	2
".....	784.....	None	".....	855.....	1
".....	785.....	None	".....	856.....	None
312.....	791.....	3	".....	857.....	6
320.....	801.....	1	".....	858.....	10
".....	802.....	1	".....	859.....	2
325.....	811.....	2	".....	860.....	None
".....	812.....	3	".....	861.....	None
".....	813.....	10	".....	862.....	3
".....	814.....	None	".....	863.....	None
".....	815.....	9	".....	864.....	None
".....	816.....	1	".....	865.....	None
".....	817.....	1	".....	866.....	None
".....	818.....	3	".....	867.....	None
326.....	831.....	42	".....	868.....	None
".....	832.....	None	".....	869.....	1
".....	833.....	5	".....	870.....	None
".....	834.....	1	".....	871.....	1
".....	835.....	3	327.....	901.....	30
".....	836.....	17	328.....	911.....	2
".....	837.....	5	".....	912.....	3
".....	838.....	10	".....	913.....	1
".....	839.....	4	".....	914.....	2
".....	840.....	10	330.....	931.....	4
".....	841.....	5	".....	932.....	1
".....	842.....	None	".....	933.....	7
".....	843.....	2	".....	934.....	None
".....	844.....	1	331.....	941.....	18
".....	845.....	10	335.....	951.....	None
".....	845A.....	(See 845)	".....	952.....	1
".....	846.....	4	".....	953.....	None
".....	847.....	None	".....	954.....	None
".....	848.....	None	".....	955.....	None
".....	849.....	None	336.....	961.....	None
".....	850.....	2	".....	962.....	None
".....	851.....	6	337.....	971.....	2
".....	852.....	1	".....	972.....	None
".....	853.....	1	338.....	981.....	None

Every Article of Regulations 45 (1918 Act) and of Regulations 62 (1921 Act) bearing specifically on the war-profits and excess-profits tax is listed in the foregoing table. The first Article is 701.

Missing Article numbers such as 702 to 710 have not yet been used.

*The last Bulletin from which rulings have  
been reproduced hereinbefore and as listed above is*

**VOLUME II (1923), No. 4.**

*Later Bulletins, since issued (if any), contain no rulings bearing on the  
1918 or 1921 excess-profits tax laws.*

**Insert this page to face blue page 401.**



Form 708  
U. S. INTERNAL REVENUE

# 1923 RETURN

## CAPITAL STOCK TAX

### FOR FOREIGN CORPORATIONS

(Collection District.)

Assessment List, Form No. 23 A.

(Month.) (Year.)

(Page.) (Line.)

(To be stamped by Collector, showing District and date received.)

Audited by \_\_\_\_\_

File with Collector of Internal Revenue for your district on or before July 31, 1922, to avoid penalty.

1. Name \_\_\_\_\_ (Print name of corporation, joint-stock company, or association.) (Show former name, if changed.)
2. Address \_\_\_\_\_ (The address in the United States must be that of the principal place of business of the corporation.)
3. Home Office located at \_\_\_\_\_ (Give street and number, city or town and country.)
4. Nature of business in detail \_\_\_\_\_ (Return for previous year filed in \_\_\_\_\_ District.)
5. Affiliated company or companies \_\_\_\_\_

## TAX PAYABLE ANNUALLY IN ADVANCE.

Return for taxable period July 1, 1922, to June 30, 1923, based on the average amount of capital employed in the transaction of its business in the United States for preceding year.

## COMPUTATION OF TAX.

Foreign Corporations. (See General Instructions 3.)

- |  |  |
|--|--|
| 6. Average capital employed in the transaction of business in the United States and elsewhere, if available: | 7. Average capital employed in the transaction of business in the United States: |
| Capital \$ _____   | Real estate \$ _____   |
| Surplus _____  | Mortgage loans _____   |
| Undivided profits _____  | Bonds held in the United States _____  |
| TOTAL \$ _____   | Stocks held in the United States _____   |
|  | Cash _____   |
|  | Other assets _____   |
|  | TOTAL \$ _____   |
| Total net income \$ _____  | Net income from sources in United States \$ _____                                |
8. Tax at the rate of \$1 for each full \$1,000 \_\_\_\_\_
9. Penalty for delinquency in filing return \_\_\_\_\_
10. Total tax and penalty \$ \_\_\_\_\_

## COMPUTATION IN SPECIAL CASES.

In the case of transportation companies owning or operating vessels plying between the United States and other countries, and any other companies where the nature of the business involves the employment of capital in the United States that is not physically maintained in this country, the following method of computation may be considered:

11. Gross amount of business for the year in the United States and elsewhere \$ \_\_\_\_\_
12. Gross amount of business for the year in the United States \_\_\_\_\_
13. Proportion (expressed in percentage) which item 12 bears to item 11 \_\_\_\_\_ %
14. Taxable amount (apply percentage found in item 13 to item 6) \$ \_\_\_\_\_
15. Tax at rate of \$1 for each full \$1,000 \_\_\_\_\_
16. Penalty for delinquency in filing return \_\_\_\_\_
17. Total tax and penalty \$ \_\_\_\_\_

STATE OF \_\_\_\_\_

COUNTY OF \_\_\_\_\_

To facilitate collection of tax a remittance in the amount reported may accompany this return.

I, \_\_\_\_\_ of the United States branch of the above-named foreign company, whose (Agent, attorney, or other official capacity.)

return for special excise tax is herein set forth, being duly sworn, depose and say that the items entered in the foregoing report and in any additional list or lists attached to or accompanying this return are, to my best knowledge and belief, and from such information as I have been able to obtain, true and correct in each and every particular.

Sworn to and subscribed before me this \_\_\_\_\_ day of \_\_\_\_\_, 192 \_\_\_\_\_

[SEAL OF OFFICER  
TAKING AFFIDAVIT.]

(Agent, attorney, or other official capacity.)

(Official capacity.)

(Name of officer or agent to whom correspondence should be addressed.)

B-9039

SEE INSTRUCTIONS ON REVERSE SIDE.

[Page 1 of Form 708.]

1923 RETURN  
CAPITAL STOCK TAX  
UNITED STATES DEPARTMENT OF THE TREASURY

Returns of this character are confidential and are open to inspection only under conditions specified in Section 257, Revenue Act of 1921.

### GENERAL INSTRUCTIONS.

1. **Nature of tax.**—The capital stock tax due July 1, 1922, is an excise tax, payable in advance, for the privilege of doing business from July 1, 1922, to June 30, 1923. The amount of the tax is computed upon the average amount of capital employed by a foreign corporation in the transaction of its business in the United States for the preceding fiscal year.

2. **Time for filing returns.**—During the month of July, and annually thereafter.

3. **Foreign corporations required to make returns.**—Every corporation engaged in business in the United States shall make return on this form irrespective of the amount of capital employed in this country in the transaction of its business, unless such corporation was not engaged in business in the United States during the preceding fiscal year, July 1, 1921, to June 30, 1922, or is specifically exempt under the provisions of Section 231, Title II, of the Revenue Act of 1921.

In supplying data under item 7, details relating to real estate, mortgage loans, etc., may be omitted, but a supplementary statement should be attached explaining how the average amount of capital employed in the transaction of its business in the United States has been computed.

4. **Examination of records and witnesses.**—For the purpose of ascertaining the correctness of any return or of making a return where none has been made or of preparing a new return where the one submitted is false or fraudulent the Commissioner has authority to designate a revenue agent or inspector to examine witnesses and books, records, papers, or other memoranda.

5. **Extension of time.**—If on account of sickness or absence of the officer charged with making the return it is impossible to prepare and file a return on or before July 31, the collector, upon application in writing, may allow an extension of not exceeding 30 days for making and filing the return. If extension is granted, the letter of the collector must be attached to the return. Neither the Commissioner nor the collector has authority to grant an extension greater than 30 days from July 31.

6. **Tentative return.**—Filing of a tentative return will avoid penalty for delinquent filing, but does not authorize withholding of the tax. Complete return as far as possible and submit an approximate estimate as a basis in order that an initial assessment may be made. (See Art. 21, Reg. 64.)

7. **Signatures and verification.**—Returns must be signed and verified by the agent or attorney, or other principal officer, in charge of the United States branch of the foreign corporation, and must be sworn to

before an officer authorized to administer oaths, and the seal of the attesting officer, if he is required to have a seal, must be impressed on the return in the space provided for that purpose. If, however, the tax covered by this return does not exceed \$10, the return may be signed or acknowledged before two witnesses instead of under oath.

8. **Corporations liable to tax.**—Every corporation created or organized outside the United States and engaged in business in the United States, shall be liable to the capital stock tax except such companies and associations as are specifically exempt under Section 231 of Title II of the Revenue Act of 1921.

9. **New corporations.**—This tax shall not be imposed upon any corporation not engaged in business in the United States for any portion of the fiscal year July 1, 1921, to June 30, 1922.

10. **Computation of tax.**—The method of computation is prescribed on the face of this form.

11. **Tax.**—The tax is at the rate of \$1 for each full \$1,000 of the average amount of capital employed in the transaction of business in the United States.

Transportation companies owning or operating vessels plying between the United States and other countries, and any other companies whose business methods involve the employment of capital in the United States which is not physically maintained in this country, may use the special method of computation suggested on the face of the return.

12. **Penalties.**—In case of any failure to make and file a return or list within the time prescribed by law, or prescribed by the Commissioner of Internal Revenue or the collector in pursuance of law, the Commissioner of Internal Revenue shall add to the tax 25 per centum of its amount, except that when a return is filed after such time and it is shown that the failure to file it was due to a reasonable cause and not to willful neglect, no such addition shall be made to the tax. In case a false or fraudulent return or list is willfully made, the Commissioner of Internal Revenue shall add to the tax 50 per centum of its amount. The tax is payable to the collector any time after July 1, 1921, but penalties for nonpayment do not attach until ten days after notice and demand has been served by the collector upon the taxpayer. (See Sections 1004, 1302, and 1311, Revenue Act of 1921, and Section 3164, R. S.)

13. **Regulations.**—For further information regarding the tax see Reg. No. 64.

RECEIVED JULY 1923

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[Page 2 of Form 708.]



Perpetual Check List  
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**Caution.**—To the extent of the imposition of the excess-profits tax for 1921, the 1918 and 1921 laws are identical, except that domestic corporations entitled to the benefits of Section 262 of the 1921 Act (§1083) are grouped with foreign corporations for the purposes of the 1921 excess-profits tax. To much the same extent, with like qualifications, the provisions of Regulations 62 (1921 Act) are essentially identical (there are frequent verbal changes) to the provisions of Regulations 45 (1918 Act). The numbering of the Articles of Regulations 62 (1921 Act) is the same as that of the respective corresponding Articles of Regulations 45 (1918 Act), except as noted below. It follows then, that, except as noted below, for the purposes of the Supplementary Bulletin Rulings, the Article reference number is the same under either Act.

Reg. 62 (1921 Act)	Reg. 45 (1918 Act)
No corresponding Article.....	to Article 712
Article 712 is the same as, therefore refer to, Article	713
“ 713 “ “ “ “ “ “ “ “ “	714
“ 714 “ “ “ “ “ “ “ “ “	715
“ 715 “ “ “ “ “ “ “ “ “	716
No corresponding Article.....	to Article 717
Article 716 is the same as, therefore refer to, Article	719
“ 717 “ “ “ “ “ “ “ “ “	718
“ 718 “ “ “ “ “ “ “ “ “	720
No corresponding Article.....	to Article 869
Article 869 is the same as, therefore refer to, Article	870
“ 870 “ “ “ “ “ “ “ “ “	871

Otherwise

Art. of Reg. 62 is same as, therefore refer to, same numbered Art. of Reg. 45  
(The list is always up-to-date.)

Law Section	Article Number	Last Ruling	Law Section	Article Number	Last Ruling
300.....	701.....	None	302.....	732.....	1
301.....	711.....	1	".....	733.....	None
".....	712.....	None	303.....	741.....	2
".....	713.....	None	".....	742.....	None
".....	714.....	11	".....	743.....	None
".....	715.....	2	304.....	751.....	None
".....	716.....	None	".....	752.....	1
".....	717.....	None	".....	753.....	None
".....	718.....	None	305.....	761.....	None
".....	719.....	1	310.....	771.....	1
".....	720.....	None	311.....	781.....	3
302.....	731.....	1	".....	782.....	None

(Over.)

Insert immediately" preceding blue page 401.

Law Section	Article Number	Last Ruling
311	783	1
"	784	None
"	785	None
312	791	3
320	801	1
"	802	1
325	811	2
"	812	3
"	813	10
"	814	None
"	815	9
"	816	1
"	817	1
"	818	3
326	831	42
"	832	None
"	833	5
"	834	1
"	835	3
"	836	17
"	837	5
"	838	10
"	839	4
"	840	10
"	841	5
"	842	None
"	843	2
"	844	1
"	845	10
"	845A	(See 845)
"	846	4
"	847	None
"	848	None
"	849	None
"	850	2
"	851	6
"	852	1
"	853	1

Law Section	Article Number	Last Ruling
326	854	2
"	855	1
"	856	None
"	857	6
"	858	10
"	859	1
"	860	None
"	861	None
"	862	3
"	863	None
"	864	None
"	865	None
"	866	None
"	867	None
"	868	None
"	869	1
"	870	None
"	871	1
327	901	30
328	911	2
"	912	3
"	913	1
"	914	2
330	931	4
"	932	1
"	933	7
"	934	None
331	941	18
335	951	None
"	952	1
"	953	None
"	954	None
"	955	None
336	961	None
"	962	None
337	971	2
"	972	None
338	981	None

Every Article of Regulations 45 (1918 Act) and of Regulations 62 (1921 Act) bearing specifically on the war-profits and excess-profits tax is listed in the foregoing table. The first Article is 701.

Missing Article numbers such as 702 to 710 have not yet been used.

*The last Bulletin from which rulings have been reproduced hereinbefore and as listed above is*

VOLUME II (1923), No. 3.

*Later Bulletins, since issued (if any), contain no rulings bearing on the 1918 or 1921 excess-profits tax laws.*

Insert this page to face blue page 401.



**Law Section 326.—Invested Capital (1918 Act—¶555, ante): (1921 Act—¶1035, post).**

**Article 859.—Effect of Stock Dividend (Reg. 45—¶814, ante): (Reg. 62—¶1230, post).**

1-19-7: T. B. R. 3.

Under the Revenue Act of 1917 stock dividends paid during any taxable year, and under the Revenue Act of 1918 stock dividends paid after the first 60 days of any taxable year, shall be deemed to have been paid from earnings or profits, but the payment of a stock dividend has no effect upon the amount of invested capital.

In determining the amount by which invested capital should be reduced on account of dividend payments made during the taxable year in excess of current earnings, should stock dividends be treated the same as cash dividends?

The following example illustrates the point in question:

Current earnings to Apr. 1, 1917.....	\$33,000
Stock dividends, Apr. 1, 1917.....	30,000
Balance current earnings undistributed.....	3,000
Earnings for April, 1917.....	12,000
Current earnings on hand May 1, 1917.....	15,000
Cash dividend May 1, 1917.....	27,000
Dividend payments in excess of current earnings.....	12,000
12,000 averaged for eight months.....	8,000

which is the amount by which invested capital as of the beginning of the year should be reduced.

The provisions of section 31 (a) of the Revenue Act of 1917, and section 201 of the Revenue Act of 1918, place stock dividends upon the same basis as cash dividends in this connection. The latter section provides, "That the term 'dividend' \* \* \* means any distribution made by a corporation \* \* \* whether in cash or in other property or in stock of the corporation out of its earnings or profits accumulated since February 28, 1913," and the definition in the Act of 1917 is substantially the same. Section 31 (b) of the Act of 1917 provides that any distribution made during the year shall be deemed to have been made from the most recently accumulated undivided profits or surplus. Section 201 (e) of the Act of 1918 provides that any distribution made after the first 60 days of any taxable year shall be deemed to have been made from current earnings or profits so far as possible. The language of these provisions is general and is susceptible of only one interpretation. It applies to all distributions of earnings, whether made in cash or in other property or in stock of the corporation. And any such distributions in excess of earnings or profits of the taxable year will reduce the surplus at the beginning of the taxable year by the amount of such excess.

The payment of a stock dividend, however, has no effect upon the amount of invested capital, article 859, Regulations 45 (final edition). The distribution of a stock dividend is in effect a capitalization of current earnings or of earned surplus on hand at the beginning of the year. The capitalization of current earnings does not increase the invested capital and the capitalization of surplus on hand at the beginning of the year does not decrease the invested capital. Nevertheless a stock dividend distributed at any time during the year under the Act of 1917 or after the first 60 days of the taxable

year under the Act of 1918 must be deemed to have been paid from current earnings or profits so far as possible, so that the accumulated earnings or profits of the taxable year available thereafter for cash dividends or other payments are correspondingly reduced. In the specific illustration given, therefore, the result is correct, but in a case in which the stock dividend was in whole or in part a capitalization of the surplus on hand at the beginning of the taxable year, no reduction in invested capital should be made because of the capitalization of such surplus.

1



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Decision	May 16, "	Malley vs. Walter Baker & Co., Ltd., 1918 Act. Sweet chocolate as candy. (See note at ¶4634.)	

Listed below are matters issued during 1923.

Decision	Feb. 7, 1923	Klepper vs. Carter, 9th. C. C. of A.—One who installs a body on a chassis, acquired from different sources, and sells the combination at retail as an automobile truck is the manufacturer thereof.....	4758
3443	" 24, "	(This T. D. reproduces, merely, the decision in Klepper vs. Carter, ¶4758 above.)	

Insert this page immediately before the blue "Sales Taxes" index.

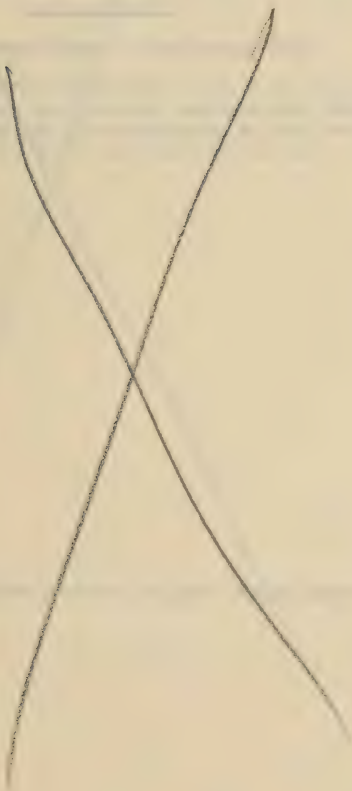




rebate on the ground that he did not manufacture, but that the shells were manufactured by independent contractors. The Court held that the purchase of elemental parts of a completed product, or the doing of subsidiary work by a subcontractor did not take from the contractor the character of a "person manufacturing," as comprehended in sec. 301 of the Munitions Tax Act of September 8, 1916, Title III, 463, 39 St. 780.

**4765** The decisions cited support us in the view that plaintiff manufactured or produced and sold complete trucks and that the judgment was right.

*Affirmed.*



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Special	Jan. 31, 1923	Instances of nontaxable transfers from trustee to substituted trustee of legal title to stock because resulting wholly from operation of law, under the laws of New York.....	4032
3446	Mar. 1, 1923	Art. 13, Reg. 40, amended.—Sales and transfers of stock not subject to tax.....	4034

Insert this sheet immediately before the blue Stamp Tax index.



## STAMP TAX REGULATIONS.

"We hereby certify that the transfer of.....shares of the within stock to.....has been made pursuant to a 'call,' and that the Federal stock transfer stamps for the transaction are affixed to such 'call,' which is in our possession.

.....  
(Seller sign here.)"

**4039** "(p) Where, under Paragraph (k) of this Article, a certificate of  
3629 stock, standing either in the name of the owner or any other person, has been delivered by the owner thereof to a broker for sale, and subsequently, under paragraph (l) of this Article, such certificate has been delivered by a broker to his customer for whom it is purchased and the tax has been paid upon the delivery of such certificate from the seller's broker to the buyer's broker, the transfer of such certificate of stock into the name of the buyer is not subject to tax, provided, that either requisite stamps shall have been affixed to the certificate of stock upon its delivery to the buyer's broker, or the memorandum of sale evidencing the transaction between the seller's broker and the buyer's broker, with the requisite stamps affixed thereto, shall have been attached to such certificate at such time and presented to the transfer agent at the time such certificate is surrendered for transfer. The old certificate, together with the memorandum of sale, if used, shall be preserved by such transfer agent for the inspection of the revenue officer."

(T. D. 3446, signed by Commissioner D. H. Blair, and dated March 1, 1923.)





## STAMP TAX REGULATIONS.

3546

## REGULATIONS 40—1922 EDITION

(Promulgated July 8, 1922—Also designated as T. D. 3380.)

(Supplemented.)

Relating to the

## STAMP TAX ON ISSUES, SALES, AND TRANSFERS OF STOCK AND SALES OF PRODUCTS FOR FUTURE DELIVERY

Under

## SUBDIVISIONS 2, 3, AND 4 OF SCHEDULE A, TITLE XI, OF THE REVENUE ACT OF 1921.

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## PART I.

## ISSUES OF STOCK.

3547 Art. 1. When tax accrues.—Stock is deemed to be issued when	
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3548 Art. 2. Rate of taxation.—(a) All certificates or instruments, of whatever designation, having a par or face value, representing shares of stock, or of profits, or of interest in property or accumulations, issued by any corporation, joint-stock company or association, are subject to tax at the rate of 5 cents on each \$100 of the face value or fraction thereof.

3549 (b) All certificates of stock, or of profits, or of interest in property or accumulations issued by any corporation, without par or face value, are subject to the tax of 5 cents per share, unless the actual value is in excess of \$100 per share, in which case the tax shall be 5 cents on each \$100 of actual value or fraction thereof, or unless the actual value is less than \$100 per share, in which case the tax shall be 1 cent on each \$20 of actual value or fraction thereof. [See ¶4016 and ¶4019].



stock" of a corporation signifies what is owned and held by the Company in its corporate character; into which franchise, etc., do not enter, although those very items form "a very essential part of the *shareholders'* capital stock." (See the same view in *People vs. Sohmer*, 179 A. D., 721, aff'd 222 N. Y., 545.) That property rather than excise taxes are considered in any given case is not material, if the search is for definitions; except as any definition is apt to be influenced by environment; and the definition of Finch, J. in the Coleman case was approvingly quoted in *Horne etc. Bank vs Des Moines*, 205 U. S., 503.

**3188** This New York concept has perhaps been applied in this Court, under a statute (30 Stat., 448) laying a privilege tax "computed on the basis of the capital and surplus of the preceding fiscal year." (*Leather, etc. Bank vs. Treat*, 128 Fed., 262; *Central etc. Co. vs. Treat*, 171 Fed., 301.) And again under an act (38 Stat. 745 (755) laying an excise to be computed on the basis of the "capital, surplus and undivided profits," etc. (*Anderson vs. Farmers' etc. Co.*, 241 Fed., 322.) But in all these cases the statutory language was far more definite than in the present instance.

**3189** Minnesota, however, has said that capital stock may mean "all the corporate possessions and possibilities; (it) represents its business opportunities and capacities as well as its tangible assets" (*Slater vs. Duluth etc. Co.*, 76 Minn., 96 (103).)

**3190** Illinois thus attempts definition: "Capital stock means \* \* \* the beneficial ownership of everything that enters into the property of the corporation, (including in the case of a railroad) the opportunities, inherent in the corporation and its franchise, of creating earnings." (*Chicago etc. Co. vs State Board*, 112 Fed., 607; and of *Pacific etc. Co. vs. Lieb*, 83 Ill., 602; *State Board vs. People*, 191 Ill., 528). In other words—within wide limits, capital stock means what the legislature wants it to mean.

**3191** In Kentucky, the Supreme Court of the United States, found that the legislature meant by capital stock "the entire property real and personal, tangible and intangible, all assets on hand and (the Company's) franchise as well," and expressed no objection to this concept of the phrase. (*Henderson etc. Co. vs. Commonwealth*, 166 U. S., 150; affirming 99 Ky., 623.) That is to say, each state can define for itself; and the right of definition is primarily in the legislature.

**3192** In Ohio also the Supreme Court found without objection that the state scheme regarded "capital stock" as representing "not only the tangible property, but also the intangible, including therein all corporate franchises and all contracts, privileges and good will of the concern." (*Adams etc. Co. vs. Ohio*, 166 U. S., 185).

**3193** Wisconsin has perhaps stated the possibilities of the phrase most conveniently for the legislator, by declaring that "capital stock" may apply to one or another of three mental concepts, (1) the stockholders' shares, (2) the corporate property, (3) a mere measure of size of corporation as a test for graduating taxes (*First National Bank vs. Douglas County*, 124 Wis., 15). The lack of fixity of meaning, the absence of any agreement in definition shown by the foregoing examples (which might be much extended) constrain to the belief that "capital stock" is a term plastic to say the least, and compelling its interpreter to look first to the context for a meaning that has not been reduced to any rigid formula.

**3194** We do not think that making the basis of computation "The fair value" of capital stock advances the matter; and we are sure that whether one speaks of a tax *on* property or a tax measured *by* property, such

variation in tax kind works *per se* no change in the meaning of the words "capital stock." "Fair" value does not import guesswork, and unless incompetence or worse be imputed to the assessor, the phrase is the exact equivalent of the "actual value" of the Coleman case.

**3195** But when the statute speaks of "estimating" capital stock, and of arriving at the "fair average value" thereof for a year—the words are so inappropriate to the process of transcribing book values, that an inference is irresistible of some other process being within the legislative intent.

**3196** When one considers further that corporate excise taxes are not new with this act of Congress—observes that this form of words is a marked departure from previous acts (*e. g.* 38 Stat., 745 *supra*), and remembers that Congress acted in the absence of any rigid legal or judicial definition of "capital stock," the interpreter is compelled to have recourse to the annals of congressional action to find out what the legislature meant and thought it said.

**3197** The remarks made by the "Committee Chairman in charge" of the bill (*United States vs. St. Paul etc. R'y*, 247 U. S., 310 (318)) are available in Cong. Rec., 64th Cong., 1st Sess., Sept. 7, 1916, and they satisfy us that the act was passed with the intent of permitting and indeed compelling the assessor to consider not only paid in capital, surplus and undivided profits but earnings and market value of shares. Such a method of assessment necessarily implies for the words "capital stock" an enlarged meaning, which if it does not connote the somewhat cynical view of the Wisconsin court (*supra*) certainly goes so far as to regard as "fair," an examination of "the entire potentiality of the corporation to profit by the exercise of its corporate franchise." (*First National Bank vs. Moon*, 102 Kan., 334, (343-344).)

**3198** If, as we find, the result reached by the assessor was and is consonant with such an examination and appraisalment, the judgment below [¶3170] was right.

Affirmed with costs.



EXHIBIT B. (See Special Instructions No. 4, page 4.)

QUOTATIONS OR OUTSIDE SALES PRICES

(Give name of exchange or specify "Outside sales.")

MONTH.	COMMON.		FIRST PREFERRED.	
	Number of shares outstanding.	Price.	Number of shares outstanding.	Price.
July, 1921		\$.....		\$.....
August, 19.....				
September, 1921				
October, 1921				
November, 1921				
December, 1921				
January, 1922				
February, 1922				
March, 1922				
April, 1922				
May, 1922				
June, 1922				
Total				
Average	x x x x x x		x x x x x x	

SPECIAL INFORMATION

Manufacturing and trading corporations will report annual gross sales for the five years shown under Exhibit C.

FISCAL YEAR ENDED	SALES.			
191	\$.....			
191				
19				
19				
19				

RECAPITULATION OF EXHIBIT B.

This column for use of taxpayer.

This column for use of Department.

Average sale value of common stock per share, \$..... multiplied by..... number of shares outstanding.....  
Average sale value of first preferred stock per share, \$..... multiplied by..... number of shares outstanding.....  
Average sale value of second preferred stock per share, \$..... multiplied by..... number of shares outstanding.....  
TOTAL (value of total capital stock reflected by Exhibit B).....

\$.....									
\$.....									

Approximate number of shares traded in during the year: Common..... Preferred.....

EXHIBIT C. (See Special Instructions No. 5, page 4.)

ANNUAL INCOME

FISCAL YEAR ENDED	NET INCOME. (Deficit in red.)	DEDUCTIONS.	ADDITIONS.	ADJUSTED INCOME.	NUMBER OF SHARES.	DIVIDENDS DECLARED.			DEPRECIATION.
						Common.	First preferred.	Second preferred.	
191	\$.....	\$.....	\$.....	\$.....		%	%	%	\$.....
191						%	%	%	
19						%	%	%	
19						%	%	%	
19						%	%	%	
Total						%	%	%	
Average	\$.....	x x x x x x	x x x x x x	\$.....		%	%	%	\$.....

RECAPITULATION OF EXHIBIT C.

This column for use of taxpayer.

This column for use of Department.

Average annual income as adjusted.....  
Capitalized at..... per cent (value of total capital stock reflected by Exhibit C).....

\$.....									
\$.....									

STATE OF.....  
COUNTY OF.....

We,....., President, and....., Treasurer, of the above-named company, whose return for special excise tax is herein set forth, being severally duly sworn, each for himself, depose and says that the items entered in the foregoing report and in any additional list or lists attached to or accompanying this return are, to his best knowledge and belief and from such information as he has been able to obtain, true and correct.

Sworn to and subscribed before me this..... day of....., 192.....

.....  
President.

[SEAL].....  
(Official capacity.)

(3)

.....  
Treasurer.  
(SEE INSTRUCTIONS ON PAGE 4.)

[Page 3 of Form 707.]

## SPECIAL INSTRUCTIONS

1. **REQUIRED VALUE.**—Every domestic corporation is required to pay annually a special estate tax with respect to carrying on or doing business, equivalent to 1 cent for each \$1,000 of so much of the fair average value of its capital stock for the preceding year ending June 30 as is in excess of \$5,000. It is immaterial whether the corporation is organized for profit or has a capital stock represented by shares.

For the purpose of this tax the fair value of the entire capital stock as a going concern, regardless of stock ownership or the ability of individual stockholders to liquidate their holdings, is required. The sales prices for any number of shares of stock less than a majority interest are not necessarily indicative of the fair value of the entire capital stock. The book value, the kind of assets, the nature of the business, good will, franchises, earning capacity, etc., are important factors that affect the worth of enterprises and must be given due consideration in arriving at the fair value at any given date.

In order that consideration may be given the various factors affecting fair value, three exhibits are provided for furnishing information, and the taxpayer will complete each exhibit or state why the required data are not available.

Exhibit A provides for adjusting any overstated or understated values contained in the taxpayer's books of account, and Exhibit C provides for showing an adjusted income, which should be the actual operating income to be used for capitalizing on a percentage basis fixed by its officers as fairly representing conditions obtaining in the trade and in the locality. If the reconstructed book value shown by Exhibit A, the market value shown by Exhibit B, or the valuation reflected by Exhibit C is greater than the valuation returned by the taxpayer, a comprehensive statement showing any extraordinary conditions which are relied on in support of the valuation claimed must be submitted. In any case in which the fair value is understated the amount will be redetermined by the Commissioner and the correct tax assessed; also any penalty incurred will be asserted.

2. **EXHIBIT B.**—The three exhibits, A, B, and C, are provided to indicate the information desired and the manner in which it should be furnished. So far as adaptable these forms should be completed by taxpayers, but if they find it more convenient they may attach to the return their own statements (as in the case of banks), provided substantially the same information is furnished. In any event, taxpayers should attach any additional statements that will aid in a comprehensive understanding of the taxpayer's return, so that the Commissioner of Internal Revenue may suitably determine the correctness of the fair value reported in item 1 on page 1 hereto.

3. **EXHIBIT A: CONDENSED BALANCE SHEET.**—Furnish under Exhibit A a condensed balance sheet as of June 30, 1922, if possible, but in no case earlier than December 31, 1921.

"Books of account."—These columns must show the amounts as carried in the taxpayer's books of account.

"Fair value."—Refer to article 1 above, defining the value required, and in the event that the columns "Books of account" contain any overstated or understated values, show herein the actual values. In the case of mines, oil and gas wells, other natural deposits, and timber, valuations established as the basis of depletion in computing income and profits taxes should be shown in the "Fair value" column. If any different valuation is claimed than reported in the "Fair value" column it may be stated and should be supported by reasonably conclusive evidence.

"Difference."—These columns will show the difference between the columns "Books of account" and "Fair value." Any material differences must be explained in such manner as to enable the Commissioner of Internal Revenue to determine if they are proper and allowable. For this purpose the differences shown herein need not be covered by corresponding adjustments in the taxpayer's books of account.

"Profit and loss."—If the "Profit and loss" balance is a debit, the amount should be shown in red.

Reserves for the payment of future dividends, whether declared or not, will not be considered as liabilities, but a reasonable amount to cover the preceding dividend period may be so considered if the dividend has been declared and not distributed. If deducted, show date declared and date of actual payment.

4. **EXHIBIT B: QUOTATIONS OR OUTSIDE SALES PRICES.**—Furnish under Exhibit B the prices quoted on a recognized stock exchange or on the New York curb, or the prices at which outside sales were made if the stock is not listed, for the period of 12 months ending June 30, 1922.

If the stock is listed, the name of the exchange from which reported quotations are taken must be shown in the space provided *thereof*, and the prices reported will be the mean of the highest and of the lowest bid prices during each month, from which the average for the year will be obtained. If the taxpayer prefers, a schedule may be attached to this return showing the highest and lowest bid prices at which stock was quoted for each day of the year and the average obtained therefrom.

If the stock is not listed and outside sales have been made at prices known or determinable by the officers making this report, such prices will be reported herein. A statement of the number of shares involved and the conditions under which sales were made at other than exchange quotations must accompany this return. Sales to employees or directors for qualifying purposes, or sales which are restricted as to resale, or sales at prices otherwise specially influenced, will not be considered representative of the fair value of the entire capital stock and should not be included.

In the column "Number of shares outstanding" should be shown the total number of shares outstanding at the close of each month. The average value per share will be determined as follows:

First. If no change occurred in the number of shares outstanding during the year, the total quotations or sales prices for the months reported and divide by the number of months in which quotations or sales prices are shown.

Second. If any change occurred in the number of shares outstanding during the year, multiply the average market price per share for the period during which the capital stock as of June 30, 1922, has been outstanding by the number of shares outstanding as of that date.

5. **EXHIBIT C: ANNUAL INCOME.**—Furnish under Exhibit C the annual income and other data for the five fiscal years ended with the close of the taxpayer's fiscal year, or for the period during which the corporation has been engaged in business if for a shorter period.

"Net income."—In this column will be shown the income returned for the purpose of the income tax and excess profits tax.

"Deductions" and "Additions."—Refer to article 1 of these Special Instructions, and show in these columns such amounts as should be deducted from or added to "Net income" to arrive at the adjusted income which may be capitalized to determine the fair value of the capital stock. A comprehensive analysis of any amounts reported therein should be attached to this return. Some of the principal items frequently requiring adjustment are:

**Deductions:**  
Income and profits taxes not deductible in computing income subject to tax.  
Interest charges not deductible in computing income subject to tax.  
Losses not fully deductible in computing income subject to tax.

**Additions:**  
Dividends from other corporations not included in computing income subject to tax.  
Income from securities of a State, municipality, or of the United States, not included in the income-tax return.

The difference between depletion allowed in determining net income subject to Federal income tax and the actual depletion based on cost.

Expenditures made for additions and betterments, or reserves for such purposes, charged against income, whether direct or through expense.

"Adjusted income."—This column will reflect the amounts resulting from the adjustment of the amounts shown in the three preceding columns.

"Number of shares."—Herein should be given the total number of shares of all classes of stock outstanding at the close of each fiscal year.

"Dividends declared."—Herein should be reported the percentage of dividends declared on each class of stock outstanding each year. The amount reported by the percentage shown in this column must not be deducted from the columns "Net income" or "Adjusted income."

"Depreciation."—Hereunder will be reported the amount actually charged against income each year in the taxpayer's books of account for depreciation.

**Capitalizing net income.**—The officers making the return will capitalize the average annual income on a percentage basis that fairly represents, under the conditions obtaining in the trade in the locality, what representative enterprises must earn in order to maintain their stock at par. In other words, if enterprises engaged in a similar business must on the average earn 12 per cent on their issued capital stock to keep the value of their stock at par, the percentage should be capitalized by dividing it by 12.

## GENERAL INSTRUCTIONS

1. **NATURE OF TAX.**—The capital stock tax due July 1, 1922, is an excise tax payable in advance for the privilege of doing business from July 1, 1922, to June 30, 1923.

2. **DATE OF FILING RETURNS.**—During July of each year.

3. **TENTATIVE RETURN.**—Filing of a tentative return will avoid penalty for delinquent filing, but does not authorize withholding of the tax. Complete return as far as possible and submit an approximate estimate as a basis in order that an initial assessment may be made. See Art. 21, Reg. 54.

4. **EXAMINATION OF RECORDS AND WITNESSES.**—For the purpose of ascertaining the correctness of any return or of making a return where none has been made or of preparing a new return where the one submitted is false or fraudulent the Commissioner has authority to designate a revenue agent or inspector to examine witnesses and books, records, papers, or other memoranda.

5. **EXTENSION OF TIME.**—If on account of sickness or absence of the officer charged with making the return, it is impossible to prepare and file a return on or before July 31, the collector, upon application in writing, may grant an extension of not exceeding 30 days for making and filing the return. If extension is granted, the letter of the collector must be attached to the return. Neither the Commissioner nor the collector has authority to grant an extension greater than 30 days from July 31.

6. **SIGNATURES AND VERIFICATION.**—Returns must be signed and verified by two officers of the corporation, that is, by the president, vice president, or other principal officer, and by the treasurer or other financial officer, and must be sworn to before an officer authorized to administer oaths, and the seal of the attesting officer, if he is required to have a seal, must be impressed on the return. The names of the corporation and the names of the officers signing the return should be plainly written or printed on the return. If, however, the tax is not over \$100, the return may be signed and acknowledged by one officer, and the return may be signed or acknowledged before two witnesses instead of under oath.

7. **TAX.**—From the total fair average value of the capital stock the sum of \$5,000 is deductible and the tax is at the rate of 1 cent for each full \$1,000 of balance. (See line 14 to 17 on page 1.)

8. **PENALTIES.**—In case of any failure to make and file a return or list within the time prescribed by law, or prescribed by the Commissioner of Internal Revenue or the collector in pursuance of law, the Commissioner of Internal Revenue shall add to the tax 25 per centum of the amount, except that when a return is due after such time and it is shown that the failure to file it was due to a reasonable cause and not to willful neglect, no such addition shall be made to the tax. In case of failure or fraudulent return or list in willfully made, the Commissioner of Internal Revenue shall add to the tax 50 per centum of its amount. The amount of the tax is payable to the collector at any time after July 1, 1922, but penalties for nonpayment do not attach until ten days after notice and demand has been served by the collector upon the taxpayer. (See sections 1400, 1402, and 1411, Revenue Act of 1921, and section 1016, T. R. C.)

9. **REGULATIONS.**—For further information regarding this tax see Regulations 64.



Form 707  
U. S. INTERNAL REVENUE**1923 RETURN  
CAPITAL STOCK TAX**

FOR DOMESTIC CORPORATIONS

(SEC. 1606, REVENUE ACT OF 1921)

(Collection district.)  
Assessment List, Form 23 A.

(Month.) (Year.)

(Page.) (Line.)

Audited by:

TO BE STAMPED BY COLLECTOR SHOWING  
DISTRICT AND DATE RECEIVEDFile with Collector of Internal Revenue for your district  
on or before July 31, 1922, to avoid penalty.

1. Name ..... (Print name of corporation, joint-stock company, or association.) (Show former name, if changed.)
2. Address ..... (The address must be that of the principal place of business. Give "Street and number," "City or town," and "State.")
3. Name of parent company, if any ..... (District filed .....)
4. Name of subsidiary, if any ..... No. shares held ..... (District filed .....)
5. Nature of business in detail .....
6. Incorporated or organized in State of ..... Month ..... Year .....
7. Return for previous year filed in ..... District ..... Fire insurance carried, if any, \$ ..... (As of date, Exhibit A.)

**TAX PAYABLE ANNUALLY IN ADVANCE**

RETURN FOR TAXABLE PERIOD JULY 1, 1922, TO JUNE 30, 1923, BASED ON FAIR AVERAGE VALUE OF CAPITAL STOCK FOR PRECEDING YEAR

CAREFULLY READ ALL INSTRUCTIONS BEFORE MAKING RETURN

JUNE 30, 1922.	Cum. or noncum.	Dividend rate.	Number of shares.	Per value per share.	TOTAL.	This column for use of Department.
8. Common stock outstanding.....	%			\$.....	\$.....	
9. First preferred stock outstanding.....	%					
10. Second preferred stock outstanding.....	%					
11. Surplus (estimate if necessary) .....						
12. Undivided profits (estimate if necessary) .....						
13. TOTAL .....						

**COMPUTATION OF TAX.**

This column for use of taxpayer.

This column for use of Department.

14. Fair value of total capital stock for fiscal year determined by Exhibit .....	\$.....	XX	\$.....	XX
15. Deduction allowed by law .....	5 0 0 0	XX	5 0 0 0	XX
16. Amount in excess of \$5,000..... (Omit cents)		XX		XX
17. Tax at rate of \$1 for each full \$1,000 in excess of \$5,000..... (Omit cents)		XX		XX
18. Penalty for delinquency in filing return .....				
19. TOTAL TAX AND PENALTY .....				

TO FACILITATE COLLECTION OF TAX A REMITTANCE IN THE AMOUNT REPORTED MAY ACCOMPANY THIS RETURN

**CLAIM SETTLEMENT RECORD**

AMOUNT .....	\$.....
ALLOWED .....	\$.....
REFLECTED .....	\$.....
FAIR VALUE .....	\$.....
BASES .....	

Every corporation must file a return or submit conclusive evidence that it is not liable. Determination of liability rests with the Commissioner. This applies to all companies claiming exemption. See Arts. 17 and 31, Regulations 64.

**ADDITIONAL ASSESSMENT RECORD**

.....	19	LIST
PAGE.....	LINE.....	
ADDITIONAL TAX, \$.....		
BY .....		

ALL TAXES ARE PAYABLE TO THE COLLECTOR OF THE DISTRICT IN WHICH RETURN IS FILED.

43-4008

(SEE INSTRUCTIONS ON PAGE 4.)

(1)

[Page 1 of Form 707.]

Copyright 1923, by The Corporation Trust Company.

WAR TAX 603 SERVICE

Returns of this character are confidential and are open to inspection only under conditions specified in Section 257, Revenue Act of 1921

EXHIBIT A. (See Special Instructions No. 3, page 4)

CONDENSED BALANCE SHEET AS OF \_\_\_\_\_

REPORT AS OF JUNE 30, 1922, IF POSSIBLE, BUT IN NO CASE EARLIER THAN DECEMBER 31, 1921

BANKS MAY ATTACH PRINTED STATEMENTS.

DEBITS AND ASSETS.	BOOKS OF ACCOUNT.	FAIR VALUE.	DIFFERENCE. *(Explain any large amounts.)
Real estate .....	\$.....	\$.....	\$.....
Buildings .....			
Machinery .....			
Stock in subsidiaries .....			
Other securities .....			
Cash .....			
Notes receivable .....			
Accounts receivable .....			
Inventory .....			
.....			
Good will, patents, etc. ....			
Deferred charges .....			
TOTALS .....	\$.....	\$.....	\$.....
CREDITS AND LIABILITIES.	BOOKS OF ACCOUNT.	FAIR VALUE.	DIFFERENCE.
Bonded debt .....	\$.....	\$.....	\$.....
Less in Treas. ....	\$.....	\$.....	\$.....
Mortgages .....			
Accounts payable .....			
Notes payable .....			
Reserves—Depreciation .....			
Depletion .....			
Taxes .....			
.....			
Deferred credits .....			
Capital stock:			
Preferred .....	\$.....		
Less in Treas. ....			
Common .....			
Less in Treas. ....			
Surplus .....			
Profit and loss .....			
TOTALS .....	\$.....	\$.....	\$.....
RECAPITULATION OF EXHIBIT A.	This column for use of taxpayer.		This column for use of Department.
Total of debits and assets after deducting items not actual assets .....	\$.....		\$.....
Less total of credits and liabilities after deducting capital stock, surplus, and other items not actual liabilities .....	\$.....		\$.....
Difference (value of total capital stock reflected by Exhibit A) .....	\$.....		\$.....

Material differences will not be allowed unless satisfactorily explained.

(SEE INSTRUCTIONS ON PAGE 4)

10-0003

(2)

[Page 2 of Form 707.]



## EXCESS PROFITS TAX.—RUNNING TABLE OF CONTENTS.

Rulings, Regulations, Opinions and Decisions  
under the

War-Profits and Excess-Profits Tax Laws.

Giving Treasury Decision Number or other Designation, General Subject Content,  
Date of Issue, and Paragraph Reference.

T. D.	Date	Subject	Paragraph
<b>1918 Law Provisions</b> .....			500
<b>Reg. 45, Pt. II-B Regulations under 1918 Act</b> (revision of January 28, 1921) as amended and supplemented to December 20, 1921.....			316
3367	July 10, 1922	Art. 836, Reg. 45, amended.—Tangible property paid in; value in excess of par value of stock.....	1265
Special	Mar. 23, 1921	Relief for 1919 under Sec. 328 not determined: computation and payment of tax for 1920.....	861
3220	Aug. 26, "	Amended returns required within 90 days when inflated values have been used in determining invested capital.....	865
Mim. 2848	Oct. 19, "	Interpretation of the foregoing.....	869
3243	Nov. 14, "	Extension of time for foregoing.....	875
A. R. M. 106	Feb. 26, "	Surplus and undivided profits: Adjustments because of alleged failure to charge off depreciation.....	877
Special	July 6, "	Explanation of the foregoing.....	879
Special	Nov. 1, "	Supplementing the foregoing.....	885
Decision	May 16, "	La Belle Iron Works vs. U. S. U. S. Supreme Court decision, Act of 1917. Invested capital.....	889
Decision	Nov. 9, 1920	DeLaski & Thropp Circular Woven Tire Co. vs. Iredell, District Court decision, Act of 1917. A corporation whose entire income is derived from royalties on patents in which it has no investment is entitled to assessment under Section 209 as being engaged in a trade or business having no invested capital or not more than a nominal capital.....	913
Decision	Apr. 19, 1921	Lincoln Chemical Co. vs. Edwards. District Court decision, 1917 Act. Additions to surplus account: Earned surplus expended in developing and improving a secret process, or used to repay borrowed money so expended.....	926
Decision	Dec. 15, "	(Above affirmed, ¶1300.) Cartier-Holland Lumber Co. vs. Doyle. U. S. Circuit Court of Appeals decision, 1917 Act. Borrowed capital in relation to the "no invested capital or not more than a nominal capital" provision of Sec. 209 of the 1917 Act.....	943
Decision	Mar. 10, 1922	Martin vs. Edwards. U. S. District Court decision, 1917 Act. Invested capital: Selling Agent: Taxability under Sec. 209 of the 1917 Act.....	968

The matters listed above are fully indexed on the blue index following page 400.

For running table of contents of matters relating to the 1921 Excess Profits Tax Law specially, and to other matters issued since the passage of that Act, see  
Excess-Profits Tax Supplementary Page 2, over.

# EXCESS PROFITS TAX.—RUNNING TABLE OF CONTENTS.

## Rulings, Regulations, Opinions and Decisions under the War-Profits and Excess-Profits Tax Laws.

Giving Treasury Decision Number or other Designation, General Subject Content,  
Date of Issue, and Paragraph Reference.

T. D.	Date	Subject	Paragraph
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The regulations, rulings, etc., listed immediately below, were issued during 1922.

1921 Law Provisions.....	1000
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Reg. 63, Pt. II-B Regulations under 1921 Act (1922 Edition). Promulgated February 15, 1922. Released for publication March 1, 1922.....	1101
3367 July 10, 1922 Art. 836, Reg. 62, amended.—Tangible property paid in; value in excess of par value of stock.....	1265
Special Jan. 16, " Allocation of tax: partnerships and corporations in consolidated cases under 1917-1921 Acts.....	Page 425
Special April, " Consolidated returns for 1917 (A. R. R. 855).....	1273
Special June, " Consolidated returns for 1917 (A. R. R. 942).....	1274
3389 Aug. 24, " Arts. 77 and 78, Reg. 41 (1917 Act) amended.—Consolidated returns, 1917.....	1289

The matters listed above are fully indexed on the blue index beginning opposite.

Decision Jan. 2, 1923 Greenport Basin and Construction Co. vs. U. S., 1917 Act.—Application of the deduction in the computation of the tax.....	1297
3429 " 19, " T. D. designation for the Greenport Basin and Construction Co. vs. U. S. decision (see Jan. 2, 1923, above) reported at ¶1297.	
Decision Feb. 5, " Lincoln Chemical Co. vs. Edwards, 2d. C. C. of A. decision, 1917 Act.—Additions to surplus account: Earned surplus expended in developing and improving a secret process, or used to repay borrowed money so expended.....	1300

Insert this page immediately before the blue Excess-Profits Tax—1921 Act—Index



## Perpetual Check List

### Supplementary Rulings Reprinted from the Internal Revenue Bulletins.

The Supplementary Rulings are printed on the pages immediately preceding.

The Foreword to the Supplementary Rulings should be read.

**Key.**—The word “none,” in the column headed “Last Ruling,” signifies in each case that there are no special rulings bearing on the particular Article of Regulations 45 (1918 Act) or of Regulations 62 (1921 Act).

The numeral, in each case, shows *how many* serially numbered special rulings bearing on the particular Article have been reproduced and indicates *the last* serial number of the group. These serial numbers appear in bold face type at the *end* of the special rulings themselves, within the Supplement.

**Caution.**—To the extent of the imposition of the excess-profits tax for 1921, the 1918 and 1921 laws are identical, except that domestic corporations entitled to the benefits of Section 262 of the 1921 Act (§1083) are grouped with foreign corporations for the purposes of the 1921 excess-profits tax. To much the same extent, with like qualifications, the provisions of Regulations 62 (1921 Act) are essentially identical (there are frequent verbal changes) to the provisions of Regulations 45 (1918 Act). The numbering of the Articles of Regulations 62 (1921 Act) is the same as that of the respective corresponding Articles of Regulations 45 (1918 Act), except as noted below. It follows then, that, except as noted below, for the purposes of the Supplementary Bulletin Rulings, the Article reference number is the same under either Act.

Reg. 62 (1921 Act)	Reg. 45 (1918 Act)
No corresponding Article.....	to Article 712
Article 712 is the same as, therefore refer to, Article 713	
“ 713 “ “ “ “ “ “ “ “ “ “	714
“ 714 “ “ “ “ “ “ “ “ “ “	715
“ 715 “ “ “ “ “ “ “ “ “ “	716
No corresponding Article.....	to Article 717
Article 716 is the same as, therefore refer to, Article 719	
“ 717 “ “ “ “ “ “ “ “ “ “	718
“ 718 “ “ “ “ “ “ “ “ “ “	720
No corresponding Article.....	to Article 869
Article 869 is the same as, therefore refer to, Article 870	
“ 870 “ “ “ “ “ “ “ “ “ “	871

#### Otherwise

Art. of Reg. 62 is same as, therefore refer to, same numbered Art. of Reg. 45

(The list is always up-to-date.)

Law Section	Article Number	Last Ruling	Law Section	Article Number	Last Ruling
300.....	701.....	None	302.....	732.....	1
301.....	711.....	1	“.....	733.....	None
“.....	712.....	None	303.....	741.....	2
“.....	713.....	None	“.....	742.....	None
“.....	714.....	11	“.....	743.....	None
“.....	715.....	2	304.....	751.....	None
“.....	716.....	None	“.....	752.....	None
“.....	717.....	None	“.....	753.....	None
“.....	718.....	None	305.....	761.....	None
“.....	719.....	1	310.....	771.....	1
“.....	720.....	None	311.....	781.....	3
302.....	731.....	1	“.....	782.....	None

(Over.)

Law Section	Article Number	Last Ruling	Law Section	Article Number	Last Ruling
311	783	1	326	854	2
"	784	None	"	855	1
"	785	None	"	856	None
312	791	3	"	857	5
320	801	1	"	858	10
"	802	1	"	859	1
325	811	2	"	860	None
"	812	3	"	861	None
"	813	10	"	862	3
"	814	None	"	863	None
"	815	9	"	864	None
"	816	1	"	865	None
"	817	1	"	866	None
"	818	3	"	867	None
326	831	42	"	868	None
"	832	None	"	869	1
"	833	5	"	870	None
"	834	1	"	871	1
"	835	3	327	901	30
"	836	17	328	911	2
"	837	5	"	912	3
"	838	10	"	913	1
"	839	4	"	914	2
"	840	10	330	931	4
"	841	5	"	932	1
"	842	None	"	933	7
"	843	2	"	934	None
"	844	1	331	941	18
"	845	10	335	951	None
"	845A	(See 845)	"	952	1
"	846	4	"	953	None
"	847	None	"	954	None
"	848	None	"	955	None
"	849	None	336	961	None
"	850	2	"	962	None
"	851	6	337	971	2
"	852	1	"	972	None
"	853	1	338	981	None

Every Article of Regulations 45 (1918 Act) and of Regulations 62 (1921 Act) bearing specifically on the war-profits and excess-profits tax is listed in the foregoing table. The first Article is 701.

Missing Article numbers such as 702 to 710 have not yet been used.

*The last Bulletin from which rulings have been reproduced hereinbefore and as listed above is*

VOLUME II (1923), No. 2.

*Later Bulletins, since issued (if any), contain no rulings bearing on the 1918 or 1921 excess-profits tax laws.*

Insert this page to face blue page 401.



Accrued excess profits tax.....	4,850.00
Net income to April 1, 1919.....	30,000.00
Excess profits tax.....	\$4,850
Proportionate part of specific exemption.....	500
	<hr/> 5,350.00
Subject to income tax at 10 per cent.....	24,650.00
Accrued income tax.....	2,465 00
Accrued profits tax.....	4,850.00
	<hr/> 7,315.00
Total accrued income and profits tax.....	7,315.00
Income to Apr. 1, 1919.....	30,000.00
Reduced by taxes to Apr. 1, 1919.....	7,315.00
	<hr/> 22,685.00
Amount net income available for dividends.....	22,685.00
Amount of dividend.....	40,000.00
Amount of income available.....	22,685.00
	<hr/> 17,315.00
Amount chargeable against surplus.....	17,315.00

The adjustment on account of this amount (\$17,315.00) averaged from April 1, 1919, to the end of the year must be made in Schedule H of Form 1120.

3

30-21-1749: C. D. 982.

In accordance with the principle set out in article 857 of Regulations 45, dividends are deemed to be paid from true earned surplus. In carrying the earnings for a proportionate part of the year to surplus account for the purpose of declaring a dividend, the earnings so carried should represent the earnings of the current year less accrued expenses. Where the true earned surplus of the current year proportioned to the date of dividend payment is not sufficient to cover such payment, the true earnings included in the surplus account as of the beginning of the taxable year will be deemed to cover such payment.

This does not conflict with the principle embodied in article 845 of the regulations. It is in accord with the accounting principle that where accounts are kept on the accrual basis, expenses of a year should be charged against the income of that year. In order, therefore, to apply this principle, taxes of the current year should be charged against the income of that year, and only that proportion of the income of the current year is available for dividends which is in excess of taxes and other proper charges against such income.

4

I('22)-29-416: I. T. 1396.

#### Revenue Act of 1918.

In computing, under the provisions of article 857, the amount of earnings available for the payment of dividends, all income for the taxable year over and above expenses, taxes, and other accrued liabilities of such year, regardless of whether or not any part of such income is exempt from Federal income tax, should be considered.

In making such computation donations previously paid must be deducted.

5





OCCUPATIONS TAXES.—RUNNING TABLE OF CONTENTS.

Rulings, Regulations, Opinions and Decisions  
under the

Occupations Tax Law Provisions.

Giving Treasury Decision Number or other Designation, General Subject Content,  
Date of Issue, and Paragraph References.

T. D.	Date	Subject	Paragraph
Law Provisions.....			7500
Reg. 59	July 20, 1922	Comprehensive regulations relating to the special taxes on businesses and occupations and on the use of boats. (See exhaustive Table of Contents beginning on page 1513.)	
Decision	Oct. 21, "	Cothran & Connally vs. U. S. 4th Circuit Court of Appeals.—Tobacco warehousemen as brokers. (See note at ¶7556.)	

Insert this page immediately before the yellow guide card "Miscellaneous Matters."





## SPECIAL TAXES ON OCCUPATIONS REGULATIONS.

ternal Revenue, give notice to each person liable to pay any taxes stated therein, to be left at his dwelling or usual place of business, or to be sent by mail, stating the amount of such taxes and demanding payment thereof. If such person does not pay the taxes within ten days after the service or the sending by mail of such notice, it shall be the duty of the collector or his deputy to collect the said taxes with a penalty of five per centum additional upon the amount of taxes, and interest at the rate of one per centum a month.

**7658** **Art. 63. Penalties.**—Any person who fails to file a return of tax due  
**8071** within the time prescribed by law or regulations made pursuant to law is liable to an additional amount equal to 25 per cent. of the total tax due except when it is shown that the failure to file the return within the prescribed time was due to a reasonable cause and not to willful neglect. If a false or fraudulent return is filed the taxpayer is liable to an additional amount equal to 50 per cent. of the total tax. A person who fails to pay or truly to account for any tax or to make any return prescribed by law is in addition to the increased tax as set forth above liable to a penalty of not more than \$1,000. If he willfully refuses to pay or account for any tax or make any return required by law, or willfully attempts in any manner to evade the tax he is guilty of a misdemeanor and in addition to the increased taxes provided for he is liable to a fine of \$10,000, or imprisonment for not more than one year, or both, together with the costs of prosecution. Where a false or fraudulent return is filed it is considered prima facie evidence of a willful attempt to evade tax and the penalties provided by law for such offense will be invoked. Under section 3184, Revised Statutes, a taxpayer who does not pay a special tax assessed within 10 days from the date of the mailing by the collector of a notice and demand for payment is liable to a 5 per cent. penalty and interest at the rate of 1 per centum per month.

**7659** **Art. 64. Claims for refund of special taxes.**—(a) In all cases where special tax has been collected and such collection is alleged to be illegal or erroneous, it will be necessary for the person so paying the tax to file claim for refund on Treasury Department Form 843, obtainable at the office of the collector. The completed claim should be filed with the collector and should be accompanied by the special-tax stamp, or receipt, representing payment of the amount claimed.

**7660** (b) No claim for the redemption of or allowance for special-tax stamps shall be allowed unless presented within two years after the purchase of said stamps from the Government. The authority for such redemption or allowance is the act of May 12, 1900 (31 Stat. 177), as amended by the act of June 30, 1902 (32 Stat. 506) [see ¶8024 herein].

**7661** (c) Where taxes are paid pursuant to an assessment and not by the issuance of stamps, claims for the refund of amounts so paid are governed by sections 3220 to 3228 R. S., as amended, and must be presented within four years next after payment of such taxes, as provided in section 1316 of the Revenue Act of 1921.

## AUTHORITY FOR REGULATIONS.

[Sec. 1309, ¶8009.]

**7662** **Art. 65. Promulgation of regulations.**—In pursuance of the statute  
**8009** the foregoing regulations are hereby made and promulgated, and all rulings inconsistent herewith are hereby revoked.

D. H. BLAIR,

*Commissioner of Internal Revenue.*

Approved: July 20, 1922. [Released for publication Aug. 2, 1922.]

A. W. <sup>3</sup>MELLON,*Secretary of the Treasury.*

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WAR TAX 1535 SERVICE





## SPECIAL TAXES ON OCCUPATIONS REGULATIONS.

## REGULATIONS 59.

[Approved July 20, 1922.]

[T. D. 3382.]

[Compiled with certain supplementary matters, as cited.]

Relating to the

SPECIAL TAXES UPON BUSINESSES AND OCCUPATIONS

and upon

THE USE OF BOATS

under

SECTIONS 1001 (SUBDIVISIONS (1) TO (11) INCLUSIVE)  
AND 1003 OF THE REVENUE ACT OF 1921

## CONTENTS.

	Paragraph
Article 1. Scope of regulations.....	7537
Section 1001. Special taxes upon businesses and occupations.....	7501
Article 2. Effective date.....	7538
3. Use of terms.....	7539
4. Basis of tax.....	7543
Section 1001 (1). Brokers.....	7502
Article 5. Persons liable.....	7544
6. Persons not liable.....	7559
7. Secondary tax.....	7581
8. Branch offices.....	7582
Section 1001 (2). Pawnbrokers.....	7503
Article 9. Delivery.....	7583
10. Persons liable.....	7584
11. Persons not liable.....	7587
Section 1001 (3). Ship brokers.....	7504
Article 12. Persons liable.....	7588
Section 1001 (4). Customhouse brokers.....	7505
Article 13. Persons liable.....	7589
Section 1001 (5). Theaters, museums, and concert halls.....	7506
Article 14. Persons liable.....	7590
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16. Theater defined.....	7592
17. Exemptions.....	7593
18. Theaters open for part of year only.....	7594
19. Seating capacity.....	7595
20. Transfer of stamp.....	7597
21. Population.....	7598
Section 1001 (6). Circuses.....	7507
Article 22. Persons liable.....	7599
23. Payment in different States.....	7600
Section 1001 (7). Other public exhibitions or shows.....	7508
Article 24. Other public exhibitions or shows for money: Taxable exhibitions.....	7601
25. Exhibitions not taxable.....	7612
26. Aggregation of entertainments.....	7613
Section 1001 (8). Bowling alleys.....	7509
Article 27. Scope of tax.....	7614
28. Transfer of special tax stamp.....	7615
Section 1001 (9). Shooting galleries.....	7510
Article 29. Persons liable.....	7616
Section 1001 (10). Riding academies.....	7511
Article 30. Liability to tax.....	7617

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## SPECIAL TAXES ON OCCUPATIONS REGULATIONS.

	Paragraph
Section 1001 (11). Passenger automobiles.....	7512
Article 31. Basis of tax.....	7618
32. Special tax stamp.....	7619
Section 1003. Special taxes upon the use of boats.....	7528
Article 33. Effective date.....	7620
34. Taxable period.....	7621
35. Basis of tax.....	7622
36. Persons liable.....	7623
37. Boats taxable.....	7624
38. Boats not subject to tax.....	7625
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40. Rate and computation of tax.....	7627
41. Tonnage.....	7629
42. Over-all length.....	7631
43. Return and payment of tax.....	7632
44. Stamp or card certificates.....	7634
Provisions of law and regulations pertaining to special taxes	
Article 45. Special taxes.....	7635
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48. Payment of one special tax not to cover several places of business	7638
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64. Claims for refund of special taxes.....	7659
Section 1309. Authority for regulations.....	8009
Article 65. Promulgation of regulations.....	7662

**7537 Art. 1. Scope of regulations.**—These regulations relate to the special taxes upon businesses and occupations, imposed by subdivisions (1) to (11), inclusive, of section 1001, and upon the use of boats, imposed by section 1003, of the Revenue Act of 1921.

## SPECIAL TAXES UPON BUSINESSES AND OCCUPATIONS.

- 7538 Art. 2. Effective date.**—The effective date of the special tax on occupations enumerated in section 1001 of the act is July 1, 1922.
- 7539 Art. 3. Use of terms.**—In these regulations—for convenience unless obviously inapplicable—
- 7540** The term "person" shall include partnerships, corporations, and associations as well as individuals;
- 7541** The term "secondary tax" shall mean the tax imposed on brokers by reason of their ownership of a membership or seat, valued at \$2,000 or more, in a stock or produce exchange, board of trade, or similar organization;
- 7542** The term "fiscal year" shall mean the period from July 1 of each calendar year to June 30, inclusive of the following calendar year.

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The Foreword to the Supplementary Rulings should be read.

The numeral, in each case, shows *how many* serially numbered special rulings bearing on the particular Article have been reproduced and indicates *the last* serial number of the group. These serial numbers appear in bold face type at the *end* of the special rulings themselves, within the Supplement.

Reg. 62 (1921 Act)	Reg. 45 (1918 Act)
No corresponding Article.....	to Article 712
Article 712 is the same as, therefore refer to, Article	713
“ 713 “ “ “ “ “ “ “ “	714
“ 714 “ “ “ “ “ “ “ “	715
“ 715 “ “ “ “ “ “ “ “	716
No corresponding Article.....	to Article 717
Article 716 is the same as, therefore refer to, Article	719
“ 717 “ “ “ “ “ “ “ “	718
“ 718 “ “ “ “ “ “ “ “	720
No corresponding Article.....	to Article 869
Article 869 is the same as, therefore refer to, Article	870
870 “ “ “ “ “ “ “ “	871

Art. of Reg. 62 is same as, therefore refer to, same numbered Art. of Reg. 45  
(The list is always up-to-date.)

(Over.)

Law Section	Article Number	Last Ruling
311	783	1
"	784	None
"	785	None
312	791	3
320	801	1
"	802	1
325	811	2
"	812	3
"	813	9
"	814	None
"	815	9
"	816	1
"	817	1
"	818	3
326	831	41
"	832	None
"	833	5
"	834	1
"	835	3
"	836	16
"	837	5
"	838	10
"	839	4
"	840	10
"	841	5
"	842	None
"	843	2
"	844	1
"	845	10
"	845A	(See 845)
"	846	4
"	847	None
"	848	None
"	849	None
"	850	2
"	851	6
"	852	1
"	853	1

Law Section	Article Number	Last Ruling
326	854	2
"	855	1
"	856	None
"	857	5
"	858	10
"	859	1
"	860	None
"	861	None
"	862	3
"	863	None
"	864	None
"	865	None
"	866	None
"	867	None
"	868	None
"	869	1
"	870	None
"	871	1
327	901	30
328	911	2
"	912	3
"	913	1
"	914	2
330	931	4
"	932	1
"	933	7
"	934	None
331	941	17
335	951	None
"	952	1
"	953	None
"	954	None
"	955	None
336	961	None
"	962	None
337	971	2
"	972	None
338	981	None

Every Article of Regulations 45 (1918 Act) and of Regulations 62 (1921 Act) bearing specifically on the war-profits and excess-profits tax is listed in the foregoing table. The first Article is 701.

Missing Article numbers such as 702 to 710 have not yet been used.

*The last Bulletin from which rulings have been reproduced hereinbefore and as listed above is*

**VOLUME II (1923), No. 1.**

*Later Bulletins, since issued (if any), contain no rulings bearing on the 1918 or 1921 excess-profits tax laws.*

**Insert this page to face blue page 401.**



The object of making this inventory was to determine the actual cash value of the physical property as of July —, 1914. A complete inventory of all items of plant and equipment on hand and in active use at January —, 1920, was taken. The date of installation of all items added since July —, 1914, has been determined from the records of the company, careful analysis of plant and expense accounts having been made by accountants. These items were further checked by information obtained from employees in the plant and the remaining items are, therefore, considered to be the items which must necessarily have been in place on July —, 1914. The prices applied to the items acquired from July —, 1914, to January —, 1920, have been actual cost prices taken from the records of the company by the accountants who worked in conjunction with the engineers.

It was then necessary to determine the value of the remaining items of equipment in the inventory as of July —, 1914.

The first step was to determine the reproduction cost of these items as of July —, 1914. This was done by using the records of the previous corporation and the records of the O Company. Preference was given to records of the previous corporation when these were available, with the exception of the buildings of the plant which were acquired at a bankrupt sale. Records of the O Company are made up almost wholly of actual sales to numerous corporations and are not based on quotations or prices given "for appraisal purposes" and are, therefore, we believe, the best evidence of the market price. Every effort has been made to have the prices applied conservative.

The reproduction cost having been determined, the next step was to determine the depreciated value and this was arrived at as follows: Competent engineers made careful examinations of each item of equipment to determine its actual condition and the accrued depreciation as of January —, 1920, was thus determined. Yearly depreciation rates were then determined and the entire plant worked back to January —, 1914, all as shown by accompanying schedules.

In explanation of the method adopted, the appraiser has sworn:

I have investigated the accounts of the predecessor corporation of the M Company and in my opinion it is impossible to correctly determine the plant value as of July —, 1914, from their books of account.

The method of accounting then in use does not show, and it is impossible to determine from the books, the expenditures made for rebuilding, renewals, replacements, and extraordinary repairs. Plant items also were charged to expense in some cases, and no consistent method of depreciating the property was ever used.

It is now contended by the appellant that the value of the buildings and machinery and equipment as of July —, 1914, as shown by the appraisal, should be employed in computing the invested capital and that in addition there should be included the par value of the 10x dollars common stock, for the reason that it represented the value to the company of the five-year agreement with A which was reasonably worth the par value of the stock.

Transmitting the appeal the Unit states:

The Unit has taken the stand that the values established by the corporation and set up on its book should be used in the absence of more definite proof of the value of the property involved. The values shown on the books can not be analyzed and it is a well recognized fact that the assets of bankrupt concerns are very often inflated.

With this in mind, we find that the officers of the new corporation revalued the assets and wrote them down to such an extent that a capital impairment of over 60 per cent resulted. The Unit contends that the officers of the corporation would not reduce the book values of its assets to a figure below the actual worth of the assets, if by so doing a substantial capital impairment was shown, unless the original values of the assets were inflated.

The Committee has carefully examined the appraisal submitted in this case and finds that it has been prepared in the manner stated by the appraisers, that the rates of depreciation used were liberal, and that it complies with the requirements of T. D. 3367 (Internal Revenue Bulletin I-30, p. 17) [¶1288 herein].

It is, therefore, believed that the appraisal constitutes sufficiently definite proof of the value of the property involved as of the date paid in for the purpose of computing invested capital, subject, of course, to check by the Unit as to the particular items and rates of depreciation.

The contention of the appellant, however, that the par value of the 10x

dollars of common stock should be added in computing invested capital does not appear to be well taken. As shown by the above recitation of facts, all the capital stock, including the common stock with the exception of *w* shares which were issued for cash, was issued for the assets of the N Company and not in consideration of services rendered or to be rendered by A. It is expressly provided in the contract entered into between the creditors' committee and A that the common stock was to be turned over to him only upon the redemption of the preferred stock within a period of five years and not otherwise. In other words, it was to be used to pay him a bonus for retiring the preferred stock within the period stated. Until the stock was actually retired, no title whatever vested in A, and the only thing back of it was the assets of the N Company, the value of which as of July —, 1914, for the purpose of invested capital has already been allowed in full in this recommendation.

It is, therefore, recommended, in the appeal of the M Company, that the action of the Income Tax Unit in reducing the appellant's invested capital as of July —, 1914, to 63.29 $\times$  dollars be reversed and that the appraisal as of that date, now filed, subject to check as to individual items, be made the basis of the computation of invested capital.



I ('22)-33-459: I. T. 1420.

**Revenue Acts of 1917, 1918, and 1921.**

In 1885 certain persons organized a corporation and a certificate of incorporation was issued to them. In 1911, in pursuance of the advice of an attorney, the company was reorganized in order to cure defects in its original organization, and the powers of the corporation were broadened, its capital increased, and its existence made perpetual. In 1914 the name of the corporation was changed and thereupon all of the assets standing in the then name of the corporation were transferred by a deed having a covenant of warranty to the corporation designated by its new corporate name.

Held, that the copy of the original charter of the corporation and of the renewed charter, and the other evidence submitted by the taxpayer, disclose that the amendmen of its charter and the subsequent change in its name did not create a new corporation, nor cause any change in its existing corporate organization. The invested capital of the corporation, accordingly, must be computed in the same manner as though the invested capital of the corporation originally formed in 1885 was being determined. The values of the assets on hand at the beginning of 1917 and later years must be determined by their values at the time of their original acquisition, as limited and defined by the Revenue Acts applicable to the taxable years involved, and their values at the date of the amendment of the corporation's charter or at the date of its change of name can not be considered for such purpose.

40

I ('22)-49-628: I. T. 1523.

**Revenue Acts of 1918 and 1921.**

If a corporation acquires patents or other intangible assets for cash, such assets may be reflected in its invested capital at an amount equal to the amount of the cash actually paid for them, but if they are acquired for stock they can be reflected in invested capital only to an amount not in excess of 25 per cent of the capital stock of the corporation outstanding at the beginning of the taxable year. This limitation prevents intangibles purchased with stock from being included at their full cost only when such cost exceeds in amount 25 per cent of the par value of the total stock or shares of the corporation outstanding at the beginning of the taxable year. No expenditures of capital made by a corporation in organization or advertising can be used to increase the value at which the patents owned by it may be reflected in its invested capital, as this amount is fixed by the cost of the acquisition of the patents, subject to the 25 per cent limitation in case they were acquired for stock.

In the case of the reorganization of a corporation which does not involve a change in corporate identity, no change takes place in the value at which its intangibles acquired for cash are to be included in its invested capital, and no change takes place in this value with reference to patents or other intangibles acquired for stock, unless the reorganization involves a change in the amount of the corporation's capital stock which is sufficient to cause a different result when the 25 per cent limitation is applied.

In case the reorganization involves a change of corporate identity through which the assets of an existing corporation are acquired by a successor, the rule applicable to the original corporation will apply in determining the amount at which the intangible assets acquired by the new corporation may be included in its invested capital. If such assets are acquired for cash, they

may be included in computing invested capital at their cost price, while if they are acquired for stock they may be included to an amount not in excess of the par value of the stock issued for the same, subject to the 25 per cent limitation, as explained above.

The statements in the preceding paragraph, however, are subject to requirements of sections 331 of the Revenue Acts of 1918 and 1921.

From the foregoing it is apparent that the reorganization of a corporation does not necessarily cause any decrease in its capital represented by patents or other intangibles.

41



Paid in or earned surplus and undivided profits not including surplus and undivided profits earned during the year.

The questions involved here rest on whether the proportionate amounts of annual earned surplus credited to the respective individual surplus account of the several stockholders were dividends, or in whole or in part earned surplus.

Article 858, Regulations 45, in so far as pertinent here reads as follows:

A dividend other than a stock dividend affects the computation of invested capital from the date when the dividend is payable and not from the date when it is declared, except that where no date is set for its payment the date when declared will be considered also the date when payable for the purpose of this article. \* \* \* From the date when any dividend is payable the amount which the several stockholders are entitled to receive will be treated as if actually paid to them, whether or not it is so paid in fact, and the surplus and undivided profits, either of the taxable year or of the preceding years, will in accordance with the foregoing provisions be deemed to be reduced as of that date by the full amount of the dividend.

The statute of Connecticut as to dividends follows the general form as that of most States. It prohibits a corporation from paying any dividend or from making any other distribution of its assets except from its net profits or actual surplus, unless in accordance with the law as to the reduction of stock or upon dissolution.

While the resolutions referred to do not specifically refer to the amounts credited to the so-called individual surplus accounts as dividends, the purpose is clear that it was intended to make available to each stockholder at least a large part if not all of the amounts so credited. This is evidenced by the large withdrawals without any further corporate action. While the usual and proper way to appropriate corporation profits to stockholders is by formally declaring a dividend, it has been very generally held that there may be a division of profits among stockholders without the formality of declaring a dividend, and that such a division is the equivalent of a dividend. (*Smith v. Moore*, 199 Fed., 689; *Hartley v. Pioneer Iron Works*, 73 N. E., 576 (N. Y.)) And it has been held that if the directors ascertain the profits and set apart the portion thereof that is to be divided, a failure to observe the forms prescribed by law as to the time, place and manner of declaring them is immaterial. (*Breslin v. Fries-Breslin Co.*, 58 Atl., 313 (N. J.)) This is the law in Connecticut. (*Cogswell v. Second National Bank*, 60 Atl., 1059, affirmed in 204 U. S., 1.)

In the instant case the directors having ascertained the profits, and set apart certain sums which were actually credited to the individual stockholders, all matters of form are immaterial. The evidence shows that at stated times the specific things necessary to warrant a declaration of dividends were done and that the profits actually made were set apart for distribution among the stockholders. This is the essence of the declaration of a dividend, so far as it results in segregating a portion of the property of the company for the use of the stockholders. Therefore, the corporation, as such, had no property interest in the money thus set apart. (*Breslin v. Fries-Breslin Co.*, supra; *Barnes v. Spencer & Barnes Co.*, 127 N. W., 752 (Mich.); *Cogswell v. Second National Bank*, supra (Conn.)) The effect of the declaration of a dividend is at once the establishment of a debt due from the corporation to each stockholder. (*Boardman v. Mansfield*, 66 Atl., 169 (Conn.); *Bishop v. Bishop*, 71 Atl., 583 (Conn.))

The amounts credited to the accounts of the respective stockholders were freely drawn upon and the amounts so credited reported as income by the individual stockholders when credited to their accounts. These are circumstances which are of great persuasive force in reaching a conclusion as to how the individual stockholders themselves considered the amounts so credited.

It is, therefore, the opinion of this office that the proportionate amounts of the annual earned surplus credited to the respective individual surplus accounts of the several stockholders were dividends, and that such surplus accounts were in effect debts owing at all times by the corporation to its stockholders, any withdrawal by individual stockholders merely being a debit against the proper individual surplus account. It follows that for the years 1917 and 1918 the net credit balances of individual surplus accounts can not be included in the invested capital of the M Company.

In accordance with the above opinion of the Solicitor, in which the Committee concurs, it is recommended that the action of the Income Tax Unit in holding that certain amounts standing as credits to the individual surplus accounts of stockholders on January 1, 1917, and January 1, 1918, represented dividends owing to its stockholders and not, as contended by the appellant, earned surplus which could properly be included in invested capital, be sustained, and, accordingly, that the appeal be denied.





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provided in Office Decision 127, S. T. 5-21-250,\* that whether or not a given transfer of legal title to stock results wholly from operation of law depends upon the effect given to the particular transaction by the law of the state in which such transaction occurred. Section 270 of the Tax Law of the State of New York (Birdseye's Consol. Laws of N. Y. Vol. VIII, p. 8607) imposes a stock transfer tax identical with that imposed by the Revenue Act of 1921 in so far as the present question is concerned. In construing Section 270 of the New York Tax Law, the following situation was encountered and presented to the Attorney General of that State for a ruling thereon:

"A testator left certain personal property, including shares of stock, in trust to be held by two named trustees, and in case of the death of either the survivor to have the right to nominate a co-trustee to succeed the one deceased. One of the trustees having died, the survivor nominated the Brooklyn Trust Company as successor co-trustee and the latter was duly appointed co-trustee with the survivor by order of the court."

"The stock in question which had stood in the joint names of the two trustees appointed by the will, and upon which stamps had been affixed at the time of the transfer to the trustees from the executors, is about to be surrendered by the surviving trustee for new certificates in the joint names of himself and the Brooklyn Trust Company as co-trustee."

Upon the above stated facts the following decision was made:

"Generally speaking, at least, the word 'transfer' as used in section 270 of the Tax Law has reference to a transaction between living parties and not to cases of devolution of title by death. (Reports of Attorney General 1911, Vol. 2, p. 107; 1912, Vol. 2, p. 211.)

"In cases of this character the title to the stock vests, by operation of law, in the succeeding trustee upon his appointment and there is no transfer within the meaning of section 270 of the Tax Law, but a mere substitution of evidences of title, which is insufficient to subject the transaction to the payment of a tax." Rept. of Attorney General (1912 N. Y.) Vol. 11, p. 352.

The above ruling was subsequently extended by the same authority to apply to the case of where two of three co-trustees resigned and pursuant to the provisions of the will the one remaining trustee appointed a fourth person to serve with him as trustee. Rept. of Attorney General (1914 N. Y.) Vol. 11, p. 345.

**4033** In view of the above mentioned opinions of the Attorney General of New York, you are advised in reply to the questions enumerated in your letter that:

(1) No stamp tax accrues on the transfer of stock from a trustee who has died to a substituted trustee appointed by a New York court to continue the same trust.

(2) No stamp tax accrues where there are two trustees and on the death of one the title is transferred from the deceased trustee to the surviving trustee alone.

(3) No stamp tax accrues where there are two or more trustees and one dies and the court appoints a new trustee to fill the place of the

\*O. D. 127 reads as follows: "Whether or not a given transfer of legal title to shares of stock results wholly from operation of law depends upon the effect given to the particular transaction by the law of the State in which such transaction occurs. If in any case any formal conveyance or act of the parties is necessary in order to vest title in the successor, such transfer is not wholly by operation of law, and is therefore subject to tax."

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one deceased with no change in the ownership of the surviving trustees; or where a trustee has resigned and a substituted trustee is appointed to continue the trust pursuant to the terms of the will.

The foregoing is applicable only in the case of transfers of stock to trustees appointed under the laws of the State of New York. (Letter to Geller, Rolston and Blanc, New York, N. Y., signed by Commissioner D. H. Blair, and dated January 31, 1923.)



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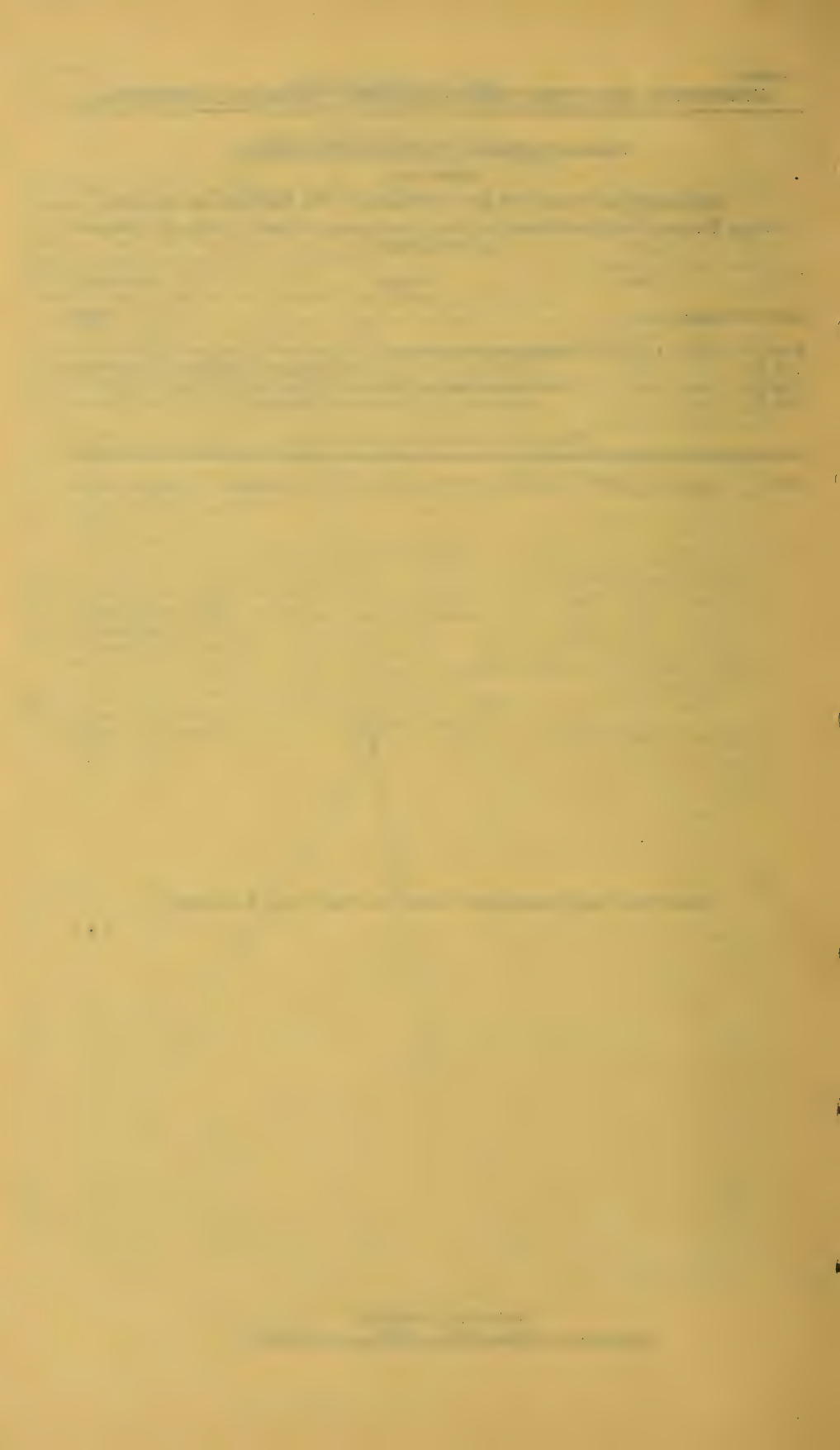
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(T. D. 3431.)

**6837** *Skating rinks: Charge for skate tickets: Court Decision.*—The decision of the District Court of the United States, Western District of Washington, Southern Division, in the case of United States v. G. H. Koller and F. M. Farmer, the syllabus of which appears below [¶6838] is published not as a ruling of the Treasury Department, but for the information of internal revenue officers and others concerned. (T. D. 3431, signed by Commissioner D. H. Blair, and dated January 22, 1923.)

[The syllabus referred to in ¶6837, above, follows.]

**6838** 1. *Nature of tax.*—The admissions tax imposed by Section 800 of the Revenue Act of 1918 is an excise tax.

**6839** 2. *Skating Rinks: Charge for Skate Tickets: Taxability.*—Where the owner of a skating rink which has operated for the general public makes an admission charge at the door of nine cents plus war tax of one cent, total ten cents, and a further charge for skate tickets which entitle the purchasers thereof to use the floor of said skating rink without extra charge, whether they use their own skates or those furnished by the said rink, the charge for skate tickets is not a rental for skates but is in fact a charge for admission to the skating floor, and is subject to the excise tax imposed by Section 800 (a) (1) and (c) of the Revenue Act of 1918.

**6840** 3. *Regulations Approved.*—Article 15 [now Art. 3, ¶6601; see beginning at ¶6617], Regulations No. 43 (Revised), Part I, is approved. (Syllabus referred to and made a part of T. D. 3431, ¶6837.)

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<b>Special</b>	Apr. 19, "	Use of rubber stamps on certificates in case of transfers of stock to broker for sale and from broker to purchasing customer.....	4003
<b>Special</b>	Sept. 20, "	Drafts payable in terms of foreign currency, accepted or delivered within U. S. ....	4004
<b>Special</b>	Nov. 4, "	Trade acceptance given in settlement of balance due on open export account is not exempt, as it is not incident to the process of export.....	4005
<b>Special</b>	Mar. 31, "	Extension or renewal of promissory note by extension of mortgage by which secured.....	4008
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<b>Special</b>	Jan. 26, 1922	Reliance of original-issue agents on statement of officials of corporation as to "actual value" of its non-par value stock.....	4016
<b>Special</b>	Jan. 26, "	Original issue tax liability on certificate representing more than one share having actual value of less than \$100.....	4019
<b>Special</b>	Feb. 3, "	Transfer of stock owned by a partnership to the individual members thereof.....	4020
<b>Special</b>	May 27, "	Stamps of large denominations in proper aggregate amount may be affixed to permanent corporation record accompanying proxies in lieu of separate stamps to the respective proxies.....	4021
<b>Special</b>	Nov. 4, 1921	Transfer of stock standing in name of brokerage firm, to and into name of successor firm, is taxable.....	4024
<b>Special</b>	Aug. 16, 1922	Transfer of stock from banking institution to its nominee is taxable.....	4026

The matters listed above are indexed.

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WAR TAX SERVICE

Stamp Taxes Supplementary Page 1.

STAMP TAXES.—RUNNING TABLE OF CONTENTS.

Rulings, Regulations, Opinions and Decisions  
under the  
Stamp Tax Law.

Issued herein since January 1, 1923.

Giving Treasury Decision Number or other Designation, General Subject Content,  
Date of Issue, and Paragraph Reference.

The matters listed below are not indexed.

T. D.	Date	Subject	Paragraph
3417	Dec. 16, 1922	Fidelity Trust Co. vs. Lederer. District Court Decision, 1918 Act. Trust Certificates issued under Pennsylvania Plan held to be taxable as "Certificates of Indebtedness".....	4027
Decision	Aug. 18, "	Haverty Furniture Co. vs. U. S. District Court decision, 1918 Act. Installment purchase agreement contracts even though embodying an "agreement to pay" in terms, are not per se promissory notes, and so, are not taxable as such.....	4028

Insert this sheet immediately before the blue Stamp Tax index.



## STAMP TAX REGULATIONS.

(T. D. 3417.)

**4027** Trust certificates issued under the Pennsylvania Plan held to be taxable as "Certificates of Indebtedness."—Comment: Decision of United States District Court, Eastern District of Pennsylvania, in *Fidelity Trust Company vs. Lederer, Collector*. Sur trial by the court sitting without a jury. After trial Judge Dickinson says: "This case, although in form assumpsit, raises the sole question of the legality of a tax levy. The very question now raised was raised and disposed of on a rule for judgment. Judgment was refused [¶4010]. This necessitated a trial hearing, but the question to be determined has in no wise changed." And in conclusion: "Our conclusion is on the trial what it was on the rule for judgment, that these car-trust certificates are subject to the tax imposed by this act of Congress." (T. D. 3417, Dec. 16, 1922. Reported in full in *Internal Revenue Bulletin No. 52 of the 1922 Series*, page 15.)

(Decision.)

Revenue Act of 1918.

August 18, 1922.

Installment purchase agreement contracts even though embodying an "agreement to pay" in terms, are not per se promissory notes, and so, are not taxable as such.

UNITED STATES DISTRICT COURT  
NORTHERN DISTRICT OF GEORGIA NORTHERN DIVISION

Haverty Furniture Co.

vs.

United States.

**4028** SAMUEL H. SIBLEY, J.—The tax sought to be recovered was collected under the Revenue Act of 1918, Schedule A6, which lays a stamp tax of 2 cents per \$100 on "drafts or checks \* \* \* promissory notes, except bank notes issued for circulation, and for each renewal of the same." The instruments here involved are claimed to be "promissory notes." They begin with the words, "This agreement witnesseth that I \* \* \* have this day purchased from the Haverty Furniture Co." and conclude with the words, "this writing is the whole contract and no verbal statements or representations are binding." They state at length the description of the furniture bought, the terms and conditions of the sale, including price and time of payment, provide for a retention of title, give an option to the seller to rescind on failure to pay and to appropriate the payments made to rent and depreciation of the furniture, and other agreements. Some of them in stating the price have the words "for which I agree to pay (so much)" others simply "for (so much)."

**4029** The suggestion that the form of contract, with the alteration of it, is an effort to evade the tax may be laid aside. Where one form of instrument is taxed and another not, one may, if he can so satisfactorily transact his affairs, avoid the form that is taxed and use that which is not. This was held in *United States vs. Isham*, 17 Wall. 496. Under the Revenue

Act of 1898, which laid a tax upon bank checks, a practice was indulged without censure by which in lieu of a check an untaxed receipt to the bank for so much money as paid to a named person was issued, and taken up by the bank on presentation. If the instruments here are promissory notes they are taxable, otherwise not. As again ruled in *Isham's case*, the taxability of such an instrument is to be determined by its face alone. Outside facts are of no importance. Nor is the practice of the Internal Revenue Department helpful here. No practice appears that decides this question. The regulations and decisions referred to furnish no test, for there is as much difficulty in applying them to the papers here in question as in applying the words of the Act.

**4030** What did Congress mean by the term "promissory notes?" It did not use such broad expressions as "all written evidences of debt," or "all written obligations to pay money." By "promissory notes," used in connection with drafts and checks, was intended commercial paper which generally throughout the United States would be so called and recognized. The exclusion of circulating bank notes illustrates what was thought otherwise to be included. Whether negotiability was contemplated or not, whether an I. O. U. or a due bill is to be included need not now be decided. But there must be an instrument at least whose plain purport is an unconditional and absolute promise to pay a fixed sum to a named or certain person at a fixed time or at sight or on demand, according to commercial usage. This much is included in all the definitions of a promissory note set forth in 7 Cyc. page 532. Instruments which appear on their face to be essentially memorandums of sale, although they evidence an obligation to pay money when the sale shall be consummated, were not intended. Such were dealt with in another portion of the Act, where only those of sales of produce for future delivery on exchanges were taxed. Looking solely to the face of these papers, there is nothing to show that the sale agreed upon therein had been executed by a delivery of the furniture. A suit for the purchase money could not be maintained by merely putting in evidence such a paper. It would have to be supplemented by proof that the seller had on his part delivered the furniture, or tendered delivery. Hence there is here no absolute unconditional promise to pay. Even those forms containing the words "for which I agree to pay" are not such. The meaning is that the buyer agrees to pay on the seller's delivering the furniture. The writings are memorandums of sale which would satisfy the statute of frauds in proving the contract, but they are not promissory notes within the meaning of this statute.

**4031** Judgment is accordingly rendered in favor of the plaintiff against the United States, for One Hundred and Fifty-eight and 91/100 Dollars and costs of suit.



# GOVERNMENT CONTRACTS PROFITS TAX RETURN

FOR FISCAL YEAR ENDING IN 1922

DO NOT WRITE IN THIS SPACE  
Examined by

(Date received)

ATTACH THIS FORM  
TO YOUR INCOME TAX  
RETURN, FORM 1120A,  
FOR THE CORRE-  
SPONDING TAXABLE  
PERIOD AS A PART  
OF THAT RETURN.

Fiscal year begun ..... 1921, and ended ..... 1922

Print plainly corporation's name and business address

(Name)

(Street and Number)

(Post Office and State)

KIND OF BUSINESS

IS THIS A CONSOLIDATED RETURN?

## SCHEDULE I—NET INCOME.

Item.

Amount.

1. AVERAGE NET INCOME FOR PREWAR PERIOD (from Form 1120 for 1918, page 1, Schedule I, Item 6)

2. NET INCOME FOR TAXABLE PERIOD (from Form 1120A for fiscal year ending in 1922, page 1, Schedule A, Item 2)

## SCHEDULE II—INVESTED CAPITAL.

Item.

Amount.

1. INVESTED CAPITAL FOR TAXABLE PERIOD (from Form 1120A for fiscal year ending in 1922, page 1, Schedule B, Item 9)

2. AVERAGE INVESTED CAPITAL FOR PREWAR PERIOD (from Form 1120 for 1918, page 1, Schedule II, Item 10)

3. INCREASE OR DECREASE IN INVESTED CAPITAL FOR TAXABLE PERIOD AS COMPARED WITH AVERAGE PREWAR INVESTED CAPITAL (indicate decrease by "D")

## SCHEDULE III—EXCESS PROFITS AND WAR PROFITS CREDITS.

### EXCESS PROFITS CREDIT.

1. Eight per cent of invested capital for taxable period (Item 1, Schedule II)

2. Exemption for domestic corporation (\$3,000)

3. EXCESS PROFITS CREDIT (Item 1 plus Item 2)

### WAR PROFITS CREDIT.

4. Average net income for prewar period (Item 1, Schedule I)

5. Plus 10% of increase or minus 10% of decrease shown by Item 3, Schedule II

6. (a) Total of (or difference between) Items 4 and 5, or (b) 10% of invested capital for taxable period (Item 1, Schedule II), whichever is larger

7. Exemption for domestic corporation (\$3,000)

8. WAR PROFITS CREDIT (Item 6 plus Item 7)

## SCHEDULE IV—COMPUTATION OF TAXES.

### WAR PROFITS AND EXCESS PROFITS TAX (BRACKETS ONE AND TWO).

1. Brackets.	2. Net Income (Item 2, Schedule I).	3. Excess Profits Credit (Item 3, Schedule III).	4. Balance Subject to Tax.	5. Rate.	6. Amount of Tax.
1. Net income not in excess of 20% of invested capital				30%	
2. Balance of net income				65%	
3. Totals					

### WAR PROFITS AND EXCESS PROFITS TAX (BRACKET THREE).

4. Net income for taxable period (Item 2, Schedule I)	7. Eighty per cent of Item 6	8. Less Item 3, column 6 (if smaller than Item 7)	9. TAX IN BRACKET THREE (Item 7 minus Item 8; if Item 8 is the larger, make no entry)
5. Less amount of War Profits Credit (Item 3, Schedule III)			
6. BALANCE			
10. Total War Profits and Excess Profits Tax as computed under Section 301(b)(1) (Item 3, column 6, plus Item 9)			
11. Total War Profits and Excess Profits Tax, if computed under Sections 302 or 337 of the Revenue Act of 1921			

## SUMMARY—WAR PROFITS AND EXCESS PROFITS TAX.

12. Total War Profits and Excess Profits Tax computed under Sections 301(b), 302, or 337, whichever is the smallest		
13. Total Excess Profits Tax (Item 3 or 4, whichever is the smaller in column 6, Schedule D, Form 1120A)		
14. That proportion of Item 12 which the income derived from Government contracts bears to the total net income		
15. That proportion of Item 13 which the income not derived from Government contracts bears to the total net income		
16. TOTAL WAR PROFITS AND EXCESS PROFITS TAX, Item 14 plus Item 15 (enter as Item 8, Schedule D, Form 1120A)		

## GENERAL INSTRUCTIONS REGARDING TAX ON INCOME DERIVED FROM GOVERNMENT CONTRACTS.

Every corporation which derives during the calendar year 1921 a net income of more than \$10,000 from any Government contract or contracts made between April 6, 1917, and November 11, 1918, both dates inclusive, the tax shall be such a proportion of a tax computed at the rates for 1918, using the excess profits credit and the war profits credit applicable to that year, as the portion of the net income attributable to the Government contracts is bears to the entire net income, plus such a proportion of a tax computed at the rates for 1921 as the amount of the remaining net income bears to the entire net income. See Section 301(b) of the Revenue Act of 1921.

Government contracts may include: (a) A contract with the United States, (b) a contract with an agency of the United States, (c) a contract with an agency of each agency, and (d) a subcontract with a contractor under any such contract, provided in every case the contract or subcontract was for the benefit of the United States. Unenforceable contracts subsequently ratified are treated as though made when originally entered into. The Commissioner may require any contractor to file with him copies of his Government contracts entered into on and after April 6, 1917.

## INSTRUCTIONS CONCERNING THE FILLING IN OF SCHEDULES IN THIS RETURN.

### SCHEDULE I, NET INCOME, AND SCHEDULE II, INVESTED CAPITAL.

If advised that prewar data called for in Schedules I and II above have been revised by the Department, enter corrected amounts. Use space below for following schedules if sufficient.

### SUPPORTING SCHEDULE.

A schedule should be submitted respecting Government contracts made between April 6, 1917, and November 11, 1918, both dates inclusive, from which a net income in excess of \$10,000 was derived during the calendar year 1921. In the case of affiliated companies, this information should be shown separately for each company. This schedule should be in columnar form and should contain the following information as respects each contract:

- Amount of contract.
- Gross income from contract during period.
- Expenses directly applicable to each contract.

Total of each column should be shown.

There should also be shown in the most practicable form:

- Total gross income of corporation.
- Percentage which total of column (b) is of (d).
- Total general expenses, losses, and deductions of corporation.
- Amount of (f) allocated to Government contracts (total).
- Percentage which (g) is of (f).

If the allocation of general expenses, losses, and deductions differs from the percentage which the gross income from the Government contract or contracts bears to the total gross income, there shall be submitted a statement showing the items and the amounts thereof which have been otherwise allocated, and the reasons therefor. If a claim is made under Section 337 of the statute, claims, profits, commissions, or other income derived on a cost-plus basis from a Government contract or contracts made between April 6, 1917, and November 11, 1918, both dates inclusive, should be shown separately from income from Government contracts of different character.

In blank.



## TABLE OF CASES.

The references are to paragraph numbers.

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3220	Aug. 26, "	Amended returns required within 90 days when inflated values have been used in determining invested capital.....	865
Mim. 2848	Oct. 19, "	Interpretation of the foregoing.....	869
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A. R. M. 106	Feb. 26, "	Surplus and undivided profits: Adjustments because of alleged failure to charge off depreciation.....	877
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Decision	Nov. 9, 1920	DeLaski & Thropp Circular Woven Tire Co. vs. Iredell. District Court decision, Act of 1917. A corporation whose entire income is derived from royalties on patents in which it has no investment is entitled to assessment under Section 209 as being engaged in a trade or business having no invested capital or not more than a nominal capital.....	913
Decision	Apr. 19, 1921	Lincoln Chemical Co. vs. Edwards. District Court decision, 1917 Act. Additions to surplus account: Earned surplus expended in developing and improving a secret process, or used to repay borrowed money so expended.....	926
Decision	Dec. 15, "	Cartier-Holland Lumber Co. vs. Doyle. U. S. Circuit Court of Appeals decision, 1917 Act. Borrowed capital in relation to the "no invested capital or not more than a nominal capital" provision of Sec. 209 of the 1917 Act.....	943
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T. D.	Date	Subject	Paragraph
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Reg. 62, Pt. II-B Regulations under 1921 Act (1922 Edition). Promulgated February 15, 1922. Released for publication March 1, 1922.....		1101
3367 July 10, 1922 Art. 836, Reg. 62, amended.—Tangible property paid in; value in excess of par value of stock.....		1265
Special Jan. 16, " Allocation of tax: partnerships and corporations in consolidated cases under 1917-1921 Acts.....		Page 425
Special April, " Consolidated returns for 1917 (A. R. R. 855).....		1273
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3389 Aug. 24, " Arts. 77 and 78, Reg. 41 (1917 Act) amended.—Consolidated returns, 1917.....		1289

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3429 " 19, "	T. D. designation for the Greenport Basin and Construction Co. vs. U. S. decision (see Jan. 2, 1923, above) reported at ¶1297.	

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### Perpetual Check List

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The Supplementary Rulings are printed on the pages immediately preceding

The Foreword to the Supplementary Rulings should be read.

**Key.**—The word "none," in the column headed "Last Ruling," signifies in each case that there are no special rulings bearing on the particular Article of Regulations 45 (1918 Act) or of Regulations 62 (1921 Act).

The numeral, in each case, shows *how many* serially numbered special rulings bearing on the particular Article have been reproduced, and indicates *the last* serial number of the group. These serial numbers appear in bold face type at the *end* of the special rulings themselves, within the Supplement.

**Caution.**—To the extent of the imposition of the excess-profits tax for 1921, the 1918 and 1921 laws are identical, except that domestic corporations entitled to the benefits of Section 262 of the 1921 Act (§1083) are grouped with foreign corporations for the purposes of the 1921 excess-profits tax. To much the same extent, with like qualifications, the provisions of Regulations 62 (1921 Act) are essentially identical (there are frequent verbal changes) to the provisions of Regulations 45 (1918 Act). The numbering of the Articles of Regulations 62 (1921 Act) is the same as that of the respective corresponding Articles of Regulations 45 (1918 Act), except as noted below. It follows then, that, except as noted below, for the purposes of the Supplementary Bulletin Rulings, the Article reference number is the same under either Act.

Reg. 62 (1921 Act)	Reg. 45, (1918 Act)
No corresponding Article.....	to Article 712
Article 712 is the same as, therefore refer to, Article	713
“ 713 “ “ “ “ “ “ “ “ “	714
“ 714 “ “ “ “ “ “ “ “ “	715
“ 715 “ “ “ “ “ “ “ “ “	716
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Article 716 is the same as, therefore refer to, Article	719
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“ 718 “ “ “ “ “ “ “ “ “	720
No corresponding Article.....	to Article 869
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870 “ “ “ “ “ “ “ “ “	871

Otherwise

Art. of Reg. 62 is same as, therefore refer to, same numbered Art. of Reg. 45

(The list is always up-to-date.)

Law Section	Article Number	Last Ruling	Law Section	Article Number	Last Ruling
300	701	None	302	732	1
301	711	1	"	733	None
"	712	None	303	741	2
"	713	None	"	742	None
"	714	11	"	743	None
"	715	2	304	751	None
"	716	None	"	752	None
"	717	None	"	753	None
"	718	None	305	761	None
"	719	1	310	771	1
"	720	None	311	781	3
302	731	1	"	782	None

(Over)

Law Section	Article Number	Last Ruling
311	783	1
"	784	None
"	785	None
312	791	3
320	801	1
"	802	1
325	811	2
"	812	3
"	813	9
"	814	None
"	815	9
"	816	1
"	817	1
"	818	3
326	831	41
"	832	None
"	833	5
"	834	1
"	835	3
"	836	16
"	837	5
"	838	10
"	839	4
"	840	10
"	841	5
"	842	None
"	843	2
"	844	1
"	845	9
"	845A	(See 845)
"	846	4
"	847	None
"	848	None
"	849	None
"	850	2
"	851	6
"	852	1
"	853	1

Law Section	Article Number	Last Ruling
326	854	2
"	855	1
"	856	None
"	857	5
"	858	10
"	859	1
"	860	None
"	861	None
"	862	3
"	863	None
"	864	None
"	865	None
"	866	None
"	867	None
"	868	None
"	869	1
"	870	None
"	871	1
327	901	30
328	911	2
"	912	3
"	913	1
"	914	2
330	931	4
"	932	1
"	933	7
"	934	None
331	941	17
335	951	None
"	952	1
"	953	None
"	954	None
"	955	None
336	961	None
"	962	None
337	971	2
"	972	None
338	981	None

Every Article of Regulations 45 (1918 Act) and of Regulations 62 (1921 Act) bearing specifically on the war-profits and excess-profits tax is listed in the foregoing table. The first Article is 701.

Missing Article numbers such as 702 to 710 have not yet been used.

*The last Bulletin from which rulings have been reproduced hereinbefore and as listed above is*

VOLUME I (1922), No. 52.

*Later Bulletins, since issued (if any), contain no rulings bearing on the 1918 or 1921 excess-profits tax laws.*

Insert this page to face blue page 401.



## Revenue Act of 1921.

I ('22) 51-643: I. T. 1532.

On January 1, 1921, the M Company's business was the property of an individual. On September 1, 1921, a corporation having the same name as that under which this business had been previously conducted took over the entire assets and liabilities of the business. The individual income tax return of the individual owner included the income from the business for the period from January 1 to August 31, 1921, while a corporation income and profits tax returns was filed by the corporation for the period from September 1 to December 31, 1921. In preparing an amended return in which the income from the business for the entire year was to be returned as the income of the corporation, under the provisions of section 229 of the Revenue Act of 1921, it was found that the withdrawal account of the former owner of the business for the period from January 1 to August 31, 1921, included an item paid by him to the collector of internal revenue in settlement of his individual income tax for the year 1920.

The question was raised as to whether the entire withdrawal account of the individual owner should be considered as a dividend paid to him by the corporation or whether the Federal income tax item should be eliminated from the withdrawal account and be considered as an item of Federal income tax paid and not as a dividend.

Held, that the item of the individual owner's withdrawal account representing the amount paid in discharge of his individual Federal income tax for 1920 should be prorated so as to represent amounts which will be proportionate to the amount of his net income for 1920 which was derived from the M Company's business and to the remaining amount of his net income which was derived from other sources, respectively.

The portion of the withdrawal made for income tax payment which is proportionate to the individual owner's net income derived from the M Company's business should not be considered as a dividend received by him from the corporation and it is not subject to tax as such. It is to be considered as a payment from the capital of the M Company's business as at December 31, 1920, and must be excluded from the amount of the assets received by the corporation in determining its invested capital at January 1, 1921.

The balance of the withdrawal made for the income tax payment which is proportionate to the individual owner's net income derived from sources other than the M Company's business, if any, is to be considered as a dividend paid by the corporation during 1921 and will be taxable as such.

All other funds withdrawn by the individual owner for personal use during the period from January 1 to August 31, 1921, must be considered as dividends paid to him by the corporation.

14576 *Ind. holosericea*?



## FORMS.

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706	Return of Gross Estate—1918 and 1921 Acts.....	13
714	Transfer agents' notice: Non-resident decedents—1918 and 1921 Acts....	33
760	Affidavit of Ownership of Bonds.....	¶382
791	Application for release of estate tax lien—Not reproduced. See ¶753 (1921 Act).	
792	Certificate releasing estate lien—Not reproduced. See ¶752 (1921 Act).	
793	Claim for military exemption from estate tax—Not reproduced. See ¶597 (1921 Act).	
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753	Certificate of registry—Not reproduced. See ¶6817.	
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1703	1704	1705	1706	1707	1708	1709	1710	1711	1712	1713	1714	1715	1716	1717	1718	1719	1720	1721	1722	1723	1724	1725	1726	1727	1728	1729	1730	1731	1732	1733	1734	1735	1736	1737	1738	1739	1740	1741	1742	1743	1744	1745	1746	1747	1748	1749	1750	1751	1752	1753	1754	1755	1756	1757	1758	1759	1760	1761	1762	1763	1764	1765	1766	1767	1768	1769	1770	1771	1772	1773	1774	1775	1776	1777	1778	1779	1780	1781	1782	1783	1784	1785	1786	1787	1788	1789	1790	1791	1792	1793	1794	1795	1796	1797	1798	1799	1800	1801	1802	1803	1804	1805	1806	1807	1808	1809	1810	1811	1812	1813	1814	1815	1816	1817	1818	1819	1820	1821	1822	1823	1824	1825	1826	1827	1828	1829	1830	1831	1832	1833	1834	1835	1836	1837	1838	1839	1840	1841	1842	1843	1844	1845	1846	1847	1848	1849	1850	1851	1852	1853	1854	1855	1856	1857	1858	1859	1860	1861	1862	1863	1864	1865	1866	1867	1868	1869	1870	1871	1872	1873	1874	1875	1876	1877	1878	1879	1880	1881	1882	1883	1884	1885	1886	1887	1888	1889	1890	1891	1892	1893	1894	1895	1896	1897	1898	1899	1900	1901	1902	1903	1904	1905	1906	1907	1908	1909	1910	1911	1912	1913	1914	1915	1916	1917	1918	1919	1920	1921	1922	1923	1924	1925	1926	1927	1928	1929	1930	1931	1932	1933	1934	1935	1936	1937	1938	1939	1940	1941	1942	1943	1944	1945	1946	1947	1948	1949	1950	1951	1952	1953	1954	1955	1956	1957	1958	1959	1960	1961	1962	1963	1964	1965	1966	1967	1968	1969	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
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## SCHEDULE L.

## RECAPITULATION, RATES OF TAX AND TAX DUE, AND JURAT.

Sched- ule.	Gross estate.	Value.
A	Real estate.....	\$.....
B	Stocks and bonds.....	.....
C	Mortgages, notes, cash, and insurance.....	.....
D	Other miscellaneous property.....	.....
E	Transfers.....	.....
F	Powers of appointment.....	.....
G	Property identified as taxed within five years.....	.....
	<b>TOTAL GROSS ESTATE</b> .....	<b>\$.....</b>

Sched- ule.	DEDUCTIONS.	Amount.
H	Funeral expenses.....	\$.....
	Administration expenses:	
	Executor's fee.....	.....
	Attorney's fee.....	.....
	Miscellaneous.....	.....
I	Debts of decedent.....	.....
J	Unpaid mortgages.....	.....
	Net losses during settlement.....	.....
	Support of dependents.....	.....
K	Property identified as taxed within five years.....	.....
	Charitable, public, and similar bequests.....	.....
	Specific exemption (resident decedents only).....	.....
	<b>TOTAL DEDUCTIONS</b> .....	<b>\$.....</b>

Total gross estate (within U. S. in nonresident estates).....	.....
Total deductions (for nonresident see Schedule M).....	.....
<b>NET ESTATE FOR TAX</b> .....	<b>\$.....</b>

2-4289

[Page 13 of Form 706.]



## ESTATE TAX REGULATIONS, ETC.

## SCHEDULE M.

## DEDUCTIONS—ESTATE OF NONRESIDENT:

If the decedent was not a resident of the United States, Hawaii, or Alaska, no deductions whatever are allowable unless the value of that part of his gross estate situated outside of the United States, Hawaii, or Alaska be set forth. If it be desired to claim deductions, execute Schedules H-I-J-K and compute the deductions allowable as follows:

1. Value of gross estate in United States (Schedules A-B-C-D-E-F-G).....	\$.....
2. Value of gross estate outside of the United States (attach itemized schedule showing values).....	.....
3. Value of total gross estate wherever situated (1 plus 2).....	.....
4. Gross deductions under Schedules H-I-J.....	.....
5. Net deductions under Schedules H-I-J (that proportion of 4 that 1 bears to 3, not exceeding 10% of 1).....	.....
6. Schedule K (within the United States).....	.....
7. Total deductions allowable (5 plus 6).....	.....
8. Net estate taxable (1 minus 7).....	.....

## RATES AND TAX DUE.

NET ESTATE.			DATE OF DEATH..... (Date.)				Amount of tax.
			(1) Sept. 9, 1916, to Mar. 2, 1917, inclusive.	(2) Mar. 3, 1917, to Oct. 3, 1917, inclusive.	(3) Oct. 4, 1917, to Feb. 24, 1919, inclusive.	(4) On and after Feb. 25, 1919.	
			Rate per cent.	Rate per cent.	Rate per cent.	Rate per cent.	
Exceeding—	Not exceeding—	Amount of block.					
	\$50,000	\$50,000	1	1½	2	1	\$.....
\$50,000	150,000	100,000	2	3	4	2	.....
150,000	250,000	100,000	3	4½	6	3	.....
250,000	450,000	200,000	4	6	8	4	.....
450,000	750,000	300,000	5	7½	10	6	.....
750,000	1,000,000	250,000	5	7½	10	8	.....
1,000,000	1,500,000	500,000	6	9	12	10	.....
1,500,000	2,000,000	500,000	6	9	12	12	.....
2,000,000	3,000,000	1,000,000	7	10	14	14	.....
3,000,000	4,000,000	1,000,000	8	12	16	16	.....
4,000,000	5,000,000	1,000,000	9	13½	18	18	.....
5,000,000	6,000,000	1,000,000	10	15	20	20	.....
6,000,000	7,000,000	1,000,000	10	15	20	20	.....
7,000,000	8,000,000	1,000,000	10	15	20	20	.....
8,000,000	9,000,000	1,000,000	10	15	22	22	.....
9,000,000	10,000,000	1,000,000	10	15	22	22	.....
10,000,000			10	15	25	25	.....
TOTAL TAX.....							\$.....

2-5299

## ESTATE TAX REGULATIONS, ETC.

## JURAT FOR EXECUTORS AND ADMINISTRATORS.

We-I \_\_\_\_\_  
 the undersigned execut \_\_\_\_\_ administrat \_\_\_\_\_, do hereby solemnly swear-affirm that on the \_\_\_\_\_ day of \_\_\_\_\_, 19\_\_\_\_, the \_\_\_\_\_ court at \_\_\_\_\_ granted letters testamentary or of administration upon the estate of the foregoing named decedent to \_\_\_\_\_; that \_\_\_\_\_ have made diligent search for property of every kind left by the decedent; that \_\_\_\_\_ have carefully read the instructions printed on this form; that hereon is listed all of the property, tangible and intangible, forming the gross estate of the decedent so far as it has come to \_\_\_\_\_ knowledge and information; that \_\_\_\_\_ have no knowledge of any transfers made or trusts created in contemplation of death or to take effect at or after death, except as stated on Schedule E; that to the best of \_\_\_\_\_ knowledge, information, and belief the value shown for each item of property listed hereon was the actual and full value of the same at the time of decedent's death; and that the debts, expenses, and charges entered hereon as deductions from the gross estate are correct and legally allowable.

## JURAT FOR BENEFICIARIES, CUSTODIANS, AND TRUSTEES.

I-We \_\_\_\_\_  
 the undersigned beneficiar \_\_\_\_\_—Custodian—Trustee, do hereby solemnly swear-affirm that \_\_\_\_\_ have carefully read the instructions printed on this form; that hereon is listed all of the property, tangible or intangible, contained in the gross estate of the decedent which has come into \_\_\_\_\_ possession and control; that to the best of \_\_\_\_\_ knowledge, information, and belief, the value shown for each item of property listed hereon was the actual and full value of the same at the time of the decedent's death; and that the debts, expenses, and charges entered hereon as deductions from the gross estate are correct and legally allowable.

(Name) \_\_\_\_\_

(Address) \_\_\_\_\_

(Name) \_\_\_\_\_

(Address) \_\_\_\_\_

(Name) \_\_\_\_\_

(Address) \_\_\_\_\_

Subscribed and sworn to before me, at \_\_\_\_\_

this \_\_\_\_\_ day of \_\_\_\_\_ 19\_\_\_\_

Notary Public—Deputy Collector.

NOTE.—If there is more than one executor or administrator all must sign and swear to the return.

Attorney's name and address \_\_\_\_\_

[Page 15 of Form 706.]















## ESTATE TAX.

**1921 Law Provisions.**—In effect after 3.55 P. M., Nov. 23, 1921.....Page 3

**Regulations No. 63**.....Page 35

In which are embodied forward references to

**Supplementary Rulings, Decisions, etc., prior to January 1, 1923**..... ¶256

All of which are fully indexed at the back of this division.

## Forms:

- 704-281 Executor's 2-month notice (resident estates).....Page 29
- 705-281 Executor's 2-month notice (nonresident estates).....Page 29\*
- 706-281 Return of gross estate.....Page 33\*
- 714-281 Transfer agent's notice: Estate of nonresident.....Page 33
- 760 Affidavit of ownership of bonds or notes.....¶382
- 791 Application for release of estate tax lien.—Not reproduced. See ¶231.
- 792 Certificate releasing estate tax lien.—Not reproduced. See ¶230.
- 793 Claim for exemption on account of military service.—Not reproduced. See ¶68.

\*To be used until revised forms are issued.

**Amendments, Rulings, Decisions, etc., since January 1, 1923**.....¶488

[See yellow Supplementary Page 2 facing the index.]

(For Supreme Court Decisions prior to January 1, 1923, see ¶397.)

## ESTATE TAX.

1921 Law Provisions.—In effect after 3.55 P. M., Nov. 23, 1921.....	Page 3
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All of which are fully indexed at the back of this division.

### Forms:

704	Executors 2-month notice (resident estates).....	Page 29
705	Executors 2-month notice (nonresident estates).....	Page 29*
706	Return of gross estate.....	Page 13*
714	Transfer agent's notice: Estate of nonresident.....	Page 33
760	Affidavit of ownership of bonds or notes; Inheritance Tax.....	¶382
791	Application for release of estate tax lien.—Not reproduced. See ¶231.	
792	Certificate releasing estate tax lien.—Not reproduced See ¶230.	
793	Claim for exemption on account of military service.—Not reproduced. See ¶68.	

\*To be used until revised forms are issued.

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Amendments, Rulings, Decisions, etc., since January 1, 1923.....	¶488
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[See yellow Supplementary Page 2 facing the index.]

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(For Supreme Court Decisions prior to January 1, 1923, see ¶397.)

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ESTATE TAX REGULATIONS, ETC.

TREASURY DEPARTMENT  
 U. S. INTERNAL REVENUE  
 Form 706—Revised November, 1919

TO BE FILED IN DUPLICATE.

Collection District .....

Date Filed .....

ASSESSMENT LIST. Form 2A.

ADDITIONAL TAX ASSESSED

AUDIT AND CLAIM RECORD.

..... (Month)	..... (Year)	Additional Tax, \$.....	Paid .....	Received .....
..... (Page)	..... (Line)	Interest \$.....	Paid .....	Amount, \$.....
Gross tax, \$.....	Paid .....			Allowed, \$.....
		Page .....	Line .....	Rejected, \$.....
Interest, \$.....	Paid .....	By .....	Date .....	By .....
				Date .....

RETURN FOR FEDERAL ESTATE TAX.

AN ITEMIZED INVENTORY BY SCHEDULE OF THE GROSS ESTATE OF THE  
DECEDENT, WITH LEGAL DEDUCTIONS.

Decedent's name ..... Date of death ....., 19.....

Residence at time of death .....

GENERAL INSTRUCTIONS—READ WITH CARE.

1. PENALTIES.—For failure to file return when due, a fine not exceeding \$500, or 25 per cent added to the tax, or both. For knowingly making a false statement in this return, a fine not exceeding \$5,000, or imprisonment, or 50 per cent added to the tax, or any or all of the three.
  2. This return is required for the estate of every resident decedent whose gross estate exceeds \$50,000, and for the estate of every nonresident decedent any part of whose gross estate is situated in the United States. The term "United States" used in this form means only the States, the Territories of Alaska and Hawaii, and the District of Columbia.
  3. This return is due one year after the date of death, and must be filed with the collector of the district in which the decedent had his permanent residence at the time of death, or, in the case of a nonresident, with the Commissioner of Internal Revenue, Treasury Department, Washington, D. C.
  4. Regulations No. 37, Revised, 1919, should be carefully studied before making out this return.
  5. All papers used in preparing the return should be carefully preserved for reference or inspection. All estate tax returns are verified by an internal revenue officer before the tax is determined by the Bureau.
  6. If the decedent left a will, a certified copy must be filed in duplicate with the return.
- There should be filed in duplicate and as a part of the return such supplemental data and statements as may be necessary to substantiate the return and establish the correct tax.
- In the case of the estate of a nonresident, there should be filed—
- (1) Certified copy of will, if decedent died testate, or of each will if decedent left more than one, to govern in different jurisdictions.
  - (2) A certified copy of inventory of the complete gross estate, whether situated within or without the United States. Separate schedules should be made for property within and without the United States, respectively.
  - (3) If any deduction is claimed, a certified copy of schedule of debts and expenses allowed.
7. This form consists of cover sheets, general information sheet, and thirteen schedules. Care should be taken to see that the return is filed complete and that all schedules are included in the proper order.
- The inventory of the gross estate must be set forth upon the schedules provided, and may not be attached in the form of an exhibit.
8. The questions asked under each schedule should be specifically answered, and if the decedent owned no property of any class specified under the schedule, the word "None" should be written across the schedule.
9. If there is not sufficient space for all entries under any schedule, use additional sheets of the same size, numbering them consecutively as follows: Schedule A-1, A-2, etc., and insert them in the proper order in the return.
10. Any property owned jointly or as tenants in the entirety, should be entered under the schedule for the particular kind of property involved, with a statement of the origin, nature, and extent of the interest. Jointly owned real estate, for example, should be entered on Schedule A.
11. Where decedent died subsequent to February 24, 1919, property identified as received from an estate taxed within five years, and subsequent to October 3, 1917, or identified as exchanged for such property, must be entered in Schedule G exclusively and not under any other schedule, whether real estate or other property.
12. Further instructions will be found under each schedule. Returns not in accordance with the instructions upon this form will not be accepted.

[Front page of Form 706.]

[For use of this Form 706 see ¶196 and ¶205.]







## ESTATE TAX REGULATIONS, ETC.

ESTATE OF \_\_\_\_\_ DISTRICT OF \_\_\_\_\_

### SCHEDULE F.

### POWERS OF APPOINTMENT.

### INSTRUCTIONS.

Property passing under a general power of appointment exercised in the decedent's will must be returned. If the decedent exercised a general power by deed, the property must be included in the gross estate if the deed was made in contemplation of death or intended to take effect at or after death, except where executed for a fair consideration in money or money's worth.

Certified copy, in duplicate, of the will or deed conferring the power upon the decedent, and of the instrument by which the power was exercised, must be filed with the return.

Property passing under the exercise of a power of appointment should not be listed under any other schedule.

For further instructions see Article 30 et seq., Regulations No. 37, Revised, 1919.

- (1) Did the decedent, at any time, by will or otherwise, transfer property by the exercise of a general power of appointment? (Answer "Yes" or "No.") \_\_\_\_\_
- (2) Did the decedent, at any time, by will or otherwise, exercise a limited power of appointment? (Answer "Yes" or "No.") \_\_\_\_\_

Item No.	Description and details.	Value on day of death.	Accrued income.
	1. _____	\$ _____	\$ _____
	2. _____	\$ _____	\$ _____
	3. _____	\$ _____	\$ _____
	4. _____	\$ _____	\$ _____
	5. _____	\$ _____	\$ _____
	6. _____	\$ _____	\$ _____
	7. _____	\$ _____	\$ _____
	8. _____	\$ _____	\$ _____
	9. _____	\$ _____	\$ _____
	10. _____	\$ _____	\$ _____
	11. _____	\$ _____	\$ _____
	12. _____	\$ _____	\$ _____
	13. _____	\$ _____	\$ _____
	14. _____	\$ _____	\$ _____
	15. _____	\$ _____	\$ _____
	16. _____	\$ _____	\$ _____
	17. _____	\$ _____	\$ _____
	18. _____	\$ _____	\$ _____
	19. _____	\$ _____	\$ _____
	20. _____	\$ _____	\$ _____
	21. _____	\$ _____	\$ _____
	22. _____	\$ _____	\$ _____
	23. _____	\$ _____	\$ _____
	24. _____	\$ _____	\$ _____
	25. _____	\$ _____	\$ _____
	26. _____	\$ _____	\$ _____
	27. _____	\$ _____	\$ _____
	28. _____	\$ _____	\$ _____
	29. _____	\$ _____	\$ _____
	30. _____	\$ _____	\$ _____
	31. _____	\$ _____	\$ _____
	32. _____	\$ _____	\$ _____
	33. _____	\$ _____	\$ _____
	34. _____	\$ _____	\$ _____
	35. _____	\$ _____	\$ _____
	36. _____	\$ _____	\$ _____
	37. _____	\$ _____	\$ _____
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## ESTATE TAX REGULATIONS, ETC.

ESTATE OF ..... TO FORMER ..... DISTRICT OF .....

## SCHEDULE D.

**OTHER MISCELLANEOUS PROPERTY.**

### INSTRUCTIONS.

Under this schedule include all items of gross estate not returned under another schedule, including the following: Debts due the decedent; interests in business; claims, rights, royalties, and pensions; leases, judgments, choses in action, shares in estates of decedents or trust funds; transfer value of fire and other protective insurance; household goods and personal effects, including wearing apparel; farm products and growing crops; live stock, automobiles, etc.

When an interest in a copartnership or unincorporated business is returned, submit in duplicate statement of assets and liabilities as of date of death and for the five years preceding death, and statement of the net earnings for the same five years. Good will must be accounted for.

In listing automobiles give make, model, and year.

Did the decedent, at the time of his death, own any interest in a copartnership or unincorporated business?  
(Answer "Yes" or "No.") \_\_\_\_\_

Did the decedent, at the time of his death, own any miscellaneous property not returnable under any other schedule? (Answer "Yes" or "No.") \_\_\_\_\_

Item No.	Description.	Value on day of death.	Accrued income.
		\$ .....	\$ .....
TOTAL.....		\$.....	\$.....
GRAND TOTAL.....			\$.....

(If more space is needed, insert additional sheet of same size.)

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MISCELLANEOUS LAW PROVISIONS AND REGULATIONS.

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revenue tax, as may have been spoiled . . . or in any manner wrongfully collected. . . . Provided further, that no claim for the redemption of or allowance for stamps shall be allowed unless presented within two years after the purchase of said stamps from the Government."

**8103** By Section 3226 Revised Statutes [§8049] no suit can be maintained in any court for the recovery of any internal revenue tax alleged to have been erroneously or illegally collected until appeal has been made to the Commissioner of Internal Revenue, as provided by law, and the decision of the Commissioner thereon has been had.

**8104** The preliminary request to the Commissioner for an informal ruling was in no sense a claim for abatement or refund. Appellant affixed the stamps to the deeds without protest and after that no effort was made to secure redemption of or allowance for the stamps until long after the two-year period had expired.

**8105** On the facts alleged in the petition the Court of Claims could not have done otherwise than sustain the demurrer. *Rock Island, Arkansas and Louisiana Railway Company v. United States*, 254 U. S. 141.

**8106** The judgment of the Court of Claims is

*Affirmed.*





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## MISCELLANEOUS LAW PROVISIONS AND REGULATIONS.

- 8086** (2) The term "corporation" includes associations, joint-stock companies, and insurance companies;
- 8087** (3) The term "domestic" when applied to a corporation or partnership means created or organized in the United States;
- 8088** (4) The term "foreign" when applied to a corporation or partnership means created or organized outside the United States;
- 8089** (5) The term "United States" when used in a geographical sense includes only the States, the Territories of Alaska and Hawaii, and the District of Columbia;
- 8090** (6) The term "Secretary" means the Secretary of the Treasury;
- 8091** (7) The term "Commissioner" means the Commissioner of Internal Revenue;
- 8092** (8) The term "collector" means collector of internal revenue;
- 8093** (9) The term "taxpayer" includes any person, trust or estate subject to a tax imposed by this Act.
- 8094** (10) The term "military or naval forces of the United States" includes the Marine Corps, the Coast Guard, the Army Nurse Corps, Female, and the Navy Nurse Corps, Female, but this shall not be deemed to exclude other units otherwise included within such terms; and
- 8095** (11) The term "government contract" means (a) a contract made with the United States, or with any department, bureau, officer, commission, board, or agency, under the United States and acting in its behalf, or with any agency controlled by any of the above if the contract is for the benefit of the United States, or (b) a subcontract made with a contractor performing such a contract if the products or services to be furnished under the subcontract are for the benefit of the United States. The term "government contract or contracts made between April 6, 1917, and November 11, 1918, both dates inclusive" when applied to a contract of the kind referred to in clause (a) of this subdivision, includes all such contracts which, although entered into during such period, were originally not enforceable, but which have been or may become enforceable by reason of subsequent validation in pursuance of law.

## Saving Clause in Event of Unconstitutionality.

- 8096** (Law.) Sec. 1403 [of the Revenue Act of 1921]. That if any provision of this Act, or the application thereof to any person or circumstances, is held invalid, the remainder of the Act, and the application of such provision to other persons or circumstances, shall not be affected thereby.

## General Effective Date of Act.

- 8097** (Law.) Sec. 1404 [of the Revenue Act of 1921]. That except as otherwise provided, this Act shall take effect upon its passage.

Approved by the President, November 23, 1921, at 3:55 P. M.





ner wrongfully collected; also to repay to any collector or deputy collector the full amount of such sums of money as may be recovered against him in any court, for any internal revenue taxes collected by him, with the cost and expenses of suit; also all damages and costs recovered against any assessor, assistant assessor, collector, deputy collector, agent, or inspector, in any suit brought against him by reason of anything done in the due performance of his official duty, and shall make report to Congress at the beginning of each regular session of Congress of all transactions under this section."

**8024** *Form 46.* Allowance for and redemption of Internal Revenue Stamps.—Form 46.—The Act entitled "An Act authorizing the Commissioner of Internal Revenue to redeem or make allowance for internal revenue stamps," approved May 12, 1900, (as amended by the act of June 30, 1902 [32 stat., 506]) provides:

That the Commissioner of Internal Revenue, subject to regulations prescribed by the Secretary of the Treasury, may, upon receipt of satisfactory evidence of the facts, make allowance for or redeem such of the stamps, issued under authority of law, to denote the payment of any internal-revenue tax, as may have been spoiled, destroyed, or rendered useless or unfit for the purpose intended, or for which the owner may have no use, or which through mistake may have been improperly or unnecessarily used, or where the rates or duties represented thereby have been excessive in amount, paid in error, or in any manner wrongfully collected. Such allowance or redemption may be made, either by giving other stamps in lieu of the stamps so allowed for or redeemed, or by refunding the amount or value to the owner thereof deducting therefrom, in case of repayment, the percentage, if any, allowed to the purchaser thereof; but no allowance or redemption shall be made in any case until the stamps so spoiled or rendered useless shall have been returned to the Commissioner of Internal Revenue, or until satisfactory proof has been made showing the reason why the same cannot be returned; or, if so required by the said Commissioner, when the person presenting the same can not satisfactorily trace the history of said stamps from their issuance to the presentation of his claim as aforesaid.

\* \* \*

**8025** *Provided further,* That no claim for the redemption of or allowance for stamps shall be allowed unless presented within two years after the purchase of said stamps from the government.

\* \* \*

**8026** Sec. 2. That the finding of facts in and the decision of the Commissioner of Internal Revenue upon the merits of any claim presented under or authorized by this Act shall, in the absence of fraud or mistake in mathematical calculation, be final and not subject to revision by any accounting officer.

**8027** Sec. 3. That all laws and parts of laws in conflict with any of the provisions of this Act are hereby repealed.

**8028** Redemption of stamps not affixed to documents or articles.—Claims for the allowance for or redemption of unused stamps must be made on Form 46, and the facts relied upon in support of the claim should be clearly

**Overpayments and Overcollections of Taxes.**

**8018** (Law.) Sec. 1304 [of the Revenue Act of 1921]. That in the case of any overpayment or overcollection of any tax imposed by section 602 [Cereal beverages, etc.] or by Title V [Facilities], Title VIII [Admissions and Dues], or Title IX [Excise or sales taxes], the person making such overpayment or overcollection may take credit therefor against taxes due upon any monthly return, and shall make refund of any excessive amount collected by him upon proper application by the person entitled thereto.

**Fractional Parts of a Cent in Payment of Tax.**

**8019** (Law.) Sec. 1306 [of the Revenue Act of 1921]. That in the payment of any tax under this Act not payable by stamp a fractional part of a cent shall be disregarded unless it amounts to one-half cent or more, in which case it shall be increased to 1 cent.

**Payment of Taxes by Check or United States Securities.**

**8020** (Law.) Sec. 1325 [of the Revenue Act of 1921]. That collectors may receive, at par with an adjustment for accrued interest, notes or certificates of indebtedness issued by the United States and uncertified checks in payment of income, war-profits and excess-profits taxes and any other taxes payable other than by stamp, during such time and under such regulations as the Commissioner, with the approval of the Secretary, shall prescribe; but if a check so received is not paid by the bank on which it is drawn the person by whom such check has been tendered shall remain liable for the payment of the tax and for all legal penalties and additions the same as if such check had not been tendered.

**Articles Exported.**

**8021** (Law.) Sec. 1305 [of the Revenue Act of 1921]. That under such rules and regulations as the Commissioner with the approval of the Secretary may prescribe, the taxes imposed under the provisions of Titles VI, VII or IX shall not apply in respect to articles sold or leased for export and in due course so exported. Under such rules and regulations the amount of any internal-revenue tax erroneously or illegally collected in respect to exported articles may be refunded to the exporter of the article, instead of to the manufacturer, if the manufacturer waives any claim for the amount so to be refunded.

**Claims for Refund and Abatement of Taxes.**

**8022** (Law.) Sec. 1315 [of the Revenue Act of 1921]. That section 3220 of the Revised Statutes, as amended, is reenacted without change, as follows:

**Section 3220 of the Revised Statutes.**

**8023** "Sec. 3220. The Commissioner of Internal Revenue, subject to regulations prescribed by the Secretary of the Treasury, is authorized to remit, refund, and pay back all taxes erroneously or illegally assessed or collected, all penalties collected without authority, and all taxes that appear to be unjustly assessed or excessive in amount, or in any man-



# STAMP TAXES.—RUNNING TABLE OF CONTENTS.

## Rulings, Regulations, Opinions and Decisions under the Stamp Tax Law.

Giving Treasury Decision Number or other Designation, General Subject Content,  
Date of Issue, and Paragraph Reference.

T. D.	Date	Subject	Paragraph
<b>Law Provisions</b> .....			3500
<b>Reg. 40</b>	July 8, 1922	Comprehensive regulations relating to stamp tax on issues, sales and transfers of stock and sales of products for future delivery. (See exhaustive Table of Contents beginning on page 709.)	
<b>Reg. 55</b>	June 12, 1922	Comprehensive regulations relating to stamp taxes on documents, fully indexed on the blue-page index at the back of this Stamp Taxes division.....	3743
<b>O. D. 83</b>	March, 1921	Taxable and tax-free issues upon a merger of corporations.	3994
<b>Decision</b>	May 31, "	Marconi Wireless Telegraph Co. vs. Duffy. District Court decision, 1918 Act. Transfer of right to receive stock.....	3998
<b>Special</b>	Feb., "	Transfer of stock from trustee to substituted trustee, when such transfer results wholly from operation of law.....	4000
<b>Special</b>	May 4, "	Transfer of stock to substituted trustee under the Massachusetts law.....	4001
<b>Special</b>	Mar. 15, "	Nominal transfer of title to stock on death of trustee to surviving trustee or trustees.....	4002
<b>Special</b>	Apr. 19, "	Use of rubber stamps on certificates in case of transfers of stock to broker for sale and from broker to purchasing customer.....	4003
<b>Special</b>	Sept. 20, "	Drafts payable in terms of foreign currency, accepted or delivered within U. S.....	4004
<b>Special</b>	Nov. 4, "	Trade acceptance given in settlement of balance due on open export account is not exempt, as it is not incident to the process of export.....	4005
<b>Special</b>	Mar. 31, "	Extension or renewal of promissory note by extension of mortgage by which secured.....	4008
<b>Special</b>	Apr. 13, "	Drafts covering bunker coal supplied in this country to foreign steamship company.....	4009
<b>Decision</b>	July 14, "	Fidelity Trust Co. vs. Lederer. District Court decision, 1918 Act. Trust certificates issued under Pennsylvania plan held to be taxable as "Certificates of Indebtedness.".....	4010
<b>Special</b>	Jan. 26, 1922	Reliance of original-issue agents on statement of officials of corporation as to "actual value" of its non-par value stock.....	4016
<b>Special</b>	Jan. 26, "	Original issue tax liability on certificate representing more than one share having actual value of less than \$100.....	4019
<b>Special</b>	Feb. 3, "	Transfer of stock owned by a partnership to the individual members thereof.....	4020
<b>Special</b>	May 27, "	Stamps of large denominations in proper aggregate amount may be affixed to permanent corporation record accompanying proxies in lieu of separate stamps to the respective proxies.....	4021
<b>Special</b>	Nov. 4, 1921	Transfer of stock standing in name of brokerage firm, to and into name of successor firm, is taxable.....	4024
<b>Special</b>	Aug. 16, 1922	Transfer of stock from banking institution to its nominee is taxable.....	4036

The matters listed above are indexed.

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WAR TAX SERVICE

Stamp Taxes Supplementary Page 1.

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**EXCESS PROFITS TAX.—RUNNING TABLE OF CONTENTS.**


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**Rulings, Regulations, Opinions and Decisions  
under the**

**War-Profits and Excess-Profits Tax Laws.**

Giving Treasury Decision Number or other Designation, General Subject Content,  
Date of Issue, and Paragraph Reference.

T. D.	Date	Subject	Paragraph
The regulations, rulings, etc., listed immediately below, were issued during 1922.			
<b>1921 Law Provisions.....</b>			<b>1000</b>
<b>Reg. 62, Pt. II-B Regulations under 1921 Act (1922 Edition).</b> Promulgated February 15, 1922. Released for publication March 1, 1922.....			
			1101
3367	July 10, 1922	<b>Art. 836, Reg. 62, amended.</b> —Tangible property paid in; value in excess of par value of stock.....	1265
Special	Jan. 16, "	Allocation of tax: partnerships and corporations in consolidated cases under 1917-1921 Acts.....	Page 425
Special	April, "	Consolidated returns for 1917 (A. R. R. 855).....	1273
Special	June, "	Consolidated returns for 1917 (A. R. R. 942).....	1274
3389	Aug. 24, "	<b>Arts. 77 and 78, Reg. 41 (1917 Act) amended.</b> —Consolidated returns, 1917.....	1289

The matters listed above are fully indexed on the blue index beginning opposite.

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Insert this page immediately before the blue Excess-Profits Tax—1921 Act—Index.



Perpetual Check List  
Supplementary Rulings Reprinted from the Internal Revenue Bulletins.

The Supplementary Rulings are printed on the pages immediately preceding.

**The Foreword to the Supplementary Rulings should be read.**

**Key.**—The word “none,” in the column headed “Last Ruling,” signifies in each case that there are no special rulings bearing on the particular Article of Regulations 45 (1918 Act) or of Regulations 62 (1921 Act).

The numeral, in each case, shows *how many* serially numbered special rulings bearing on the particular Article have been reproduced, and indicates *the last* serial number of the group. These serial numbers appear in bold face type at the *end* of the special rulings themselves, within the Supplement.

**Caution.**—To the extent of the imposition of the excess-profits tax for 1921, the 1918 and 1921 laws are identical, except that domestic corporations entitled to the benefits of Section 262 of the 1921 Act (§1083) are grouped with foreign corporations for the purposes of the 1921 excess-profits tax. To much the same extent, with like qualifications, the provisions of Regulations 62 (1921 Act) are essentially identical (there are frequent verbal changes) to the provisions of Regulations 45 (1918 Act). The numbering of the Articles of Regulations 62 (1921 Act) is the same as that of the respective corresponding Articles of Regulations 45 (1918 Act), except as noted below. It follows then, that, except as noted below, for the purposes of the Supplementary Bulletin Rulings, the Article reference number is the same under either Act.

Reg. 62 (1921 Act)	Reg. 45, (1918 Act)
No corresponding Article.....	to Article 712
Article 712 is the same as, therefore refer to, Article	713
“ 713 “ “ “ “ “ “ “ “ “ “	714
“ 714 “ “ “ “ “ “ “ “ “ “	715
“ 715 “ “ “ “ “ “ “ “ “ “	716
No corresponding Article.....	to Article 717
Article 716 is the same as, therefore refer to, Article	719
“ 717 “ “ “ “ “ “ “ “ “ “	718
“ 718 “ “ “ “ “ “ “ “ “ “	720
No corresponding Article.....	to Article 869
Article 869 is the same as, therefore refer to, Article	870
870 “ “ “ “ “ “ “ “ “ “	871

Otherwise

Art. of Reg. 62 is same as, therefore refer to, same numbered Art. of Reg. 45

(The list is always up-to-date.)

Law Section	Article Number	Last Ruling	Law Section	Article Number	Last Ruling
300	701	None	302	732	1
301	711	1	"	733	None
"	712	None	303	741	2
"	713	None	"	742	None
"	714	11	"	743	None
"	715	2	304	751	None
"	716	None	"	752	None
"	717	None	"	753	None
"	718	None	305	761	None
"	719	1	310	771	1
"	720	None	311	781	3
302	731	1	"	782	None

(Over)

Law Section	Article Number	Last Ruling	Law Section	Article Number	Last Ruling
311	783	1	326	854	2
"	784	None	"	855	1
"	785	None	"	856	None
312	791	3	"	857	5
320	801	1	"	858	10
"	802	1	"	859	1
325	811	2	"	860	None
"	812	3	"	861	None
"	813	9	"	862	3
"	814	None	"	863	None
"	815	9	"	864	None
"	816	1	"	865	None
"	817	None	"	866	None
"	818	3	"	867	None
326	831	40	"	868	None
"	832	None	"	869	1
"	833	4	"	870	None
"	834	1	"	871	1
"	835	3	327	901	30
"	836	15	328	911	2
"	837	5	"	912	3
"	838	10	"	913	1
"	839	4	"	914	2
"	840	9	330	931	4
"	841	5	"	932	1
"	842	None	"	933	7
"	843	2	"	934	None
"	844	1	331	941	17
"	845	8	335	951	None
"	845A	(See 845)	"	952	1
"	846	4	"	953	None
"	847	None	"	954	None
"	848	None	"	955	None
"	849	None	336	961	None
"	850	2	"	962	None
"	851	6	337	971	2
"	852	1	"	972	None
"	853	1	338	981	None

Every Article of Regulations 45 (1918 Act) and of Regulations 62 (1921 Act) bearing specifically on the war-profits and excess-profits tax is listed in the foregoing table. The first Article is 701.

Missing Article numbers such as 702 to 710 have not yet been used.

*The last weekly Bulletin from which rulings have been reproduced hereinbefore and as listed above is*

VOLUME I (1922), No. 47.

*Later Bulletins, since issued (if any), contain no rulings bearing on the 1918 or 1921 excess-profits tax laws.*

Insert this page to face blue page 401.



I ('22)—15-219: I. T. 1278.

**Revenue Act of 1921.**

Inquiry is made as to whether the cost of rotogravure supplements comes within the purview of A. R. M. 141 [Ruling No. 8, above], which permits taxpayers engaged in the publication of newspapers to include in their invested capital, for tax purposes, moneys expended out of earned surplus or current earnings for the sole purpose of building up the circulation structure. It is stated that newspaper publishers employ rotogravure supplements largely as a circulation stimulant.

The question to be determined in cases affected by the ruling above referred to is whether the amounts claimed as an addition to invested capital can be identified as having been expended out of earned surplus or current earnings for the sole purpose of building up the circulation structure. It is believed that rotogravure supplements constitute a part of the news service furnished by newspapers to their subscribers and are not of such a nature that the expense thereof can be said to be incurred solely for the purpose of building up the circulation structure. It, therefore, follows that the moneys expended therefor may not be added to invested capital.

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of 10x dollars for the payment of these notes, and it should have reduced its surplus accordingly.

It might be, as between the stockholders and creditors of the corporations, that the stockholders would be held estopped from denying that they still owe these notes to the corporation, but that is extremely doubtful, and could be determined only upon the happening of that contingency. However that may be, such an estoppel would not set up these notes as valid and legal obligations, but would only estop the stockholders from claiming that they had already been paid.

It is suggested, therefore, that the surplus account of the corporation be reduced each year by the amount which it paid as a dividend in satisfaction of these notes as they fell due. This conclusion necessarily reduced the corporation's invested capital by 40x dollars prior to the year 1917, and requires an adjustment on account of the 10x dollar note paid on June 1, 1917.

In view of the foregoing quoted opinion, with which the Committee is in accord, it is recommended that the surplus account of the corporation be reduced each year by the amount which was paid as a dividend in satisfaction of these notes as they fell due, and that the corporation's invested capital be reduced by 40x dollars prior to the year 1917 and a further adjustment of invested capital be made as of June 1, 1917, on account of the note paid through the medium of a special dividend on that date. Accordingly, it is recommended that the action of the Income Tax Unit be sustained and the taxpayer's appeal be denied.

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I ('22)-31-444: I. T. 1409.

#### Revenue Act of 1918.

Section 8632 of the Ohio General Code, which provides that at the time of making a subscription 10 per cent on each share subscribed for shall be paid, and which provides that the residue shall be paid in such installments at the times and places and to such persons as the directors require, has been construed by the Ohio courts as merely marking the time when the first installment shall be payable upon a stock subscription and as providing the mode for determining the time at which the residue shall become payable. (*Chamberlain v. Railroad*, 15 Ohio State, 249.) Stock issued without the payment of the first 10 per cent at the time of making the subscription is not invalid. (*Smith v. Railroad*, 15 Ohio State, 336, and *Henry v. Railroad*, 13 Ohio Reports, 187.) A note given for such 10 per cent is enforceable (*Latham v. Insurance Co.*, 1 Bull., 127.)

In view of the above interpretation, it is held that, under the provisions of section 8632 of the Ohio General Code, promissory notes of subscribers may legally be received in respect of the entire amount of stock subscribed. Consequently, it follows that all the notes received by the M Company upon stock subscriptions may be included in the company's invested capital to the extent of their fair market value at the time paid in under the provisions of article 833 of Regulations 45, provided they were received in absolute payment and not as conditional payment only.

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**Revenue Acts of 1917, 1918, and 1921.**

In 1885 certain persons organized a corporation and a certificate of incorporation was issued to them. In 1911, in pursuance of the advice of an attorney, the company was reorganized in order to cure defects in its original organization, and the powers of the corporation were broadened, its capital increased, and its existence made perpetual. In 1914 the name of the corporation was changed and thereupon all of the assets standing in the then name of the corporation were transferred by a deed having a covenant of warranty to the corporation designated by its new corporate name.

Held, that the copy of the original charter of the corporation and of the renewed charter, and the other evidence submitted by the taxpayer, disclose that the amendmen of its charter and the subsequent change in its name did not create a new corporation, nor cause any change in its existing corporate organization. The invested capital of the corporation, accordingly, must be computed in the same manner as though the invested capital of the corporation originally formed in 1885 was being determined. The values of the assets on hand at the beginning of 1917 and later years must be determined by their values at the time of their original acquisition, as limited and defined by the Revenue Acts applicable to the taxable years involved, and their values at the date of the amendment of the corporation's charter or at the date of its change of name can not be considered for such purpose.

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